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No. 00-730

In The

Supreme Court of the United States

ADARAND CONSTRUCTORS, INC.,

Petitioner,

v.

NORMAN Y. MINETA, Secretary of the United States Department of Transportation, *et al.*,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Tenth Circuit

PETITIONER'S BRIEF ON THE MERITS

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QUESTIONS PRESENTED

1. Whether the Court of Appeals misapplied the strict scrutiny standard in determining if Congress had a compelling interest to enact legislation designed to remedy the effects of racial discrimination?

2. Whether the United States Department of Transportation's current Disadvantaged Business Enterprise program is narrowly tailored to serve a compelling governmental interest?

LIST OF PARTIES

By operation of law, Secretary of Transportation Norman Y. Mineta has replaced Rodney Slater as a Respondent in this case, who in turn replaced Federico Peña. Furthermore, Kenneth Wykle was a Respondent in his capacity as Administrator of the Federal Highway Administration ("FHA"), but that office is currently vacant. Finally, the Department of Transportation has undergone large scale reorganization, which renders it unclear to Petitioner who, if anyone, replaced former Respondents Vincent F. Schimholler, who was Administrator of Region VIII of the FHA, and Larry C. Smith, who was Division Engineer of the Central Federal Lands Highway Division, as Respondents. All parties are sued in their official capacities.

Petitioner Adarand Constructors, Inc. has no parent or subsidiary companies. No publicly held company owns ten percent or more of the stock of Adarand Constructors, Inc.

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OPINIONS BELOW

In this case the Court will review the opinion of the United States Court of Appeals for the Tenth Circuit entered on September 25, 2000 *sub nom. Adarand Constructors, Inc. v. Slater, et al.*, 228 F.3d 1147 (10th Cir. 2000), reproduced in Appendix to Petition for *Certiorari* ("Pet. App.") 1-97, reversing summary judgment for Adarand granted by the United States District Court for the District of Colorado *sub nom. Adarand Constructors, Inc. v. Peña, et al.*, 965 F.Supp. 1556 (D. Colo. 1997), Pet. App. 128-201.

BASIS OF JURISDICTION

Section 1254(1) of title 28 of the United States Code grants this Court jurisdiction to review the Tenth Circuit's decision in this case.

CONSTITUTIONAL PROVISIONS INVOLVED

This case concerns the Equal Protection component of the Due Process Clause of the Fifth Amendment to the United States Constitution, which reads in pertinent part: "No person shall . . . be deprived of . . . liberty . . . without due process of law."

STATUTES AND REGULATIONS INVOLVED

The statutes involved in this case include § 1101(b) of the Transportation Equity Act for the Twenty First Century ("TEA-21"), Pub. L. No. 105-178, 112 Stat. 107, *et seq.*, Pet. App. 300-04; and sections 8(a), 8(d) and 644(g) of the Small Business Act, 15 USC §§ 637(a), (d), 644(g), Pet. App. 305-16.

The regulations involved in this case include Small Business Administration regulations at 13 CFR Part 124; Federal Acquisition Regulations at 48 CFR Part 19; and DOT regulations at 49 CFR Part 26.

STATEMENT OF THE CASE

This case began over a decade ago when Adarand Constructors, Inc. ("Adarand") sued the Secretary of the United States Department of Transportation ("DOT") and other DOT officials (collectively, "Respondents"). Adarand challenged the federal statutory regime by which DOT awards federal highway construction contracts on the basis of race. This Court has referred to that regime as the Disadvantaged Business Enterprise ("DBE") program. This Court is familiar with the rudiments of the regime and with the undisputed facts. Certain elements of the procedural history require illumination, however, and the statutory regime has never been fully presented to this Court. It is also necessary to dispel two misconceptions regarding this case. Therefore, the facts, procedural history, statutory regime, and misconceptions are presented separately below.

A. Facts

Adarand incurred the injury that forms the basis of this case in 1989 when, as a direct result of DOT's race-based contracting practices, a prime contractor hired by DOT awarded a subcontract to a certified DBE instead of Adarand. Mountain Gravel & Construction Company ("Mountain Gravel") bid on and won the federal prime contract in question, called the West Dolores River Project, which was let directly by DOT. Among other work, the prime contract called for installation of guardrails. Gonzalez Construction Company ("Gonzales") and Adarand are both guardrail installation subcontractors. Both submitted bids to Mountain Gravel. Adarand's was lowest. As a condition of being eligible to win the prime contract, however, Congress had required each bidder to submit a detailed DBE subcontractor hiring plan, unless that bidder came within certain exceptions to that rule. Further, Congress required DOT to make the winning bidder's DBE hiring plan a material part of the contract, subject to liquidated damages for breach. DOT also

offered winning bidders, including Mountain Gravel, a ten thousand dollar bonus for hiring a DBE. Like all four of Adarand's principle competitors, Gonzalez is a certified DBE. Adarand is not. Therefore, as a result of DOT's stick and carrot arrangement, Mountain Gravel rejected Adarand's low bid and hired Gonzales. These facts are not disputed. Pet. App. 104-05.

B. Procedural History

Adarand filed this suit in 1990. From the beginning, Adarand has sought a declaration that the statutory regime that results in DOT's race-based contracting practices violates the Equal Protection requirements of the United States Constitution. Appendix to Reply to Brief In Opposition to Petition for *Certiorari* ("Reply. App.") 4-9.

The parties filed cross motions for summary judgment in April 1991. At that time, Respondents (Defendants below) filed no disparity study with the court. *See* Defendants' Brief In Support Of Their Motion For Summary Judgment, filed April 24, 1991. Nevertheless, in 1992, the United States District Court for the District of Colorado granted summary judgment to Respondents after applying only intermediate scrutiny. *Adarand v. Skinner*, 790 F.Supp. 240 (D. Colo. 1992). A panel of the Tenth Circuit affirmed two years later. *Adarand v. Peña*, 16 F.3d 1537 (10th Cir. 1994). In 1995, this Court reversed and remanded, ordering the lower courts to apply strict scrutiny to the entire regime. Pet. App. 202, 243.

On remand, the parties again filed cross motions for summary judgment in May 1996. By way of evidence in support of Respondents' motion, despite months of discovery to choose from, Respondents' attorneys prepared and filed only a short document called "Appendix I." Defendants' Memorandum In Support Of Their Motion For Summary Judgment, filed May 1, 1996 (Appendix I reprinted in its entirety at Pet. App. 367-78). Appendix I purports to summarize the legislative history of the racially discriminatory provisions of the Small Business

Act and highway funding statutes originally challenged in this case. Adarand objected that "[t]here is absolutely nothing in Appendix I that could be described as 'evidence of discrimination.' " Memorandum Of Points And Authorities In Opposition To Defendants' Motion For Summary Judgment And In Support Of Plaintiff's Motion For Summary Judgment 7 n.6., filed June 3, 1996.

Later, Respondents' attorneys composed an alleged synopsis of anecdotal evidence and disparity studies collected and conducted for entities other than Congress or DOT. Then they published their synopsis in the Federal Register as "Appendix A" to a document called "Proposed Reforms to Affirmative Action In Federal Procurement: A Preliminary Survey." 61 Fed. Reg. 26041, 26050 (May 23, 1996). The composition and publication of Appendix A was in direct response to this Court's first ruling in this case. *Id.* at 26042 ("proposal set forth herein . . . designed to ensure compliance with the constitutional standards established by the Supreme Court in *Adarand* . . . "). Next, Respondents filed their attorneys' purported synopsis as an appendix to their response to Adarand's motion for summary judgment. Defendants' Memorandum In Opposition To Plaintiff's Motion For Summary Judgment And In Further Support Of Defendants' Motion For Summary Judgment 6, filed June 3, 1996. Respondents called their attorneys' work "significant evidence." *Id.* Respondents did not, however, submit any of the studies or statements their attorneys had purportedly summarized. To date, in fact, the record contains not one page of any disparity study, nor any detailed explanation of the methods used in any of the studies Respondents' attorneys cited in Appendix A. Again, Adarand pointed out that Respondents had "failed to provide the evidence upon which Congress relied in passing the race-based measures challenged in this case." Plaintiff's Reply Memorandum 7-8, filed June 17, 1996.

In 1997, the District Court denied Respondents' motion for summary judgment and granted summary judgment to Adarand instead, holding the challenged

regime unconstitutional. Pet. App. 128, 200. Respondents appealed.

In their opening brief to the Tenth Circuit, Respondents indicated that the District Court had considered their attorneys' Federal Register publication in making its decision. Brief For The Federal Appellants 13 n.12, filed Nov. 19, 1997. Adarand again objected that the only putative evidence before the District Court was Respondents' attorneys' version of the legislative history, which is not "evidence," in the legal sense, at all. Adarand further argued that unless "the evidence used by Congress to make its findings [is] presented to the Court, the Court cannot do its job." Brief For Appellee 27, 33, filed Jan. 23, 1998.

Before the panel ruled on the pending appeal, Congress once again perpetuated the DBE program when it passed the Transportation Equity Act for the Twenty First Century ("TEA-21"). TEA-21 is the current federal spending authorization act regarding highway construction and maintenance.[1] The DBE program has now been in effect for nearly a quarter of a century. *See* Pub. L. No. 95-507 (1978).

In August 1998, Respondents moved to dismiss their own appeal on grounds of mootness. Their motion was based on a state regulation then in effect in Colorado but that DOT has since stricken as illegal. Reply App. 1-3. In February 1999, before the panel ruled on that motion, DOT published a final rule changing some of the regulations that govern the continuing DBE program. 64 Fed. Reg. 5096 (Feb. 2, 1999). In March 1999, the panel held the case had indeed become moot. Pet. App. 115, 123.

In January 2000, this Court again reversed and remanded, *per curiam* and without dissent, finding that

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[1] Enacted June 9, 1998. Pub. L. 105-178, Tit. I, § 1101(b), 112 Stat. 113. TEA-21 is the successor appropriations measure to the Intermodal Surface Transp. Efficiency Act (ISTEA). 105 Stat. 1919, § 1003(b); Pet. App. 103 n.1.

the matter was not moot because it was capable of repetition but avoiding review. Pet. App. 103, 111. Ordered to resolve this case on its merits, the Tenth Circuit again assigned this case to the same panel this Court had just reversed.

The panel's first action on this second remand was to request supplemental briefs on whether the case could be moot despite this Court's decision. Order, Feb. 24, 2000. The panel also requested briefs on the relevance of the intervening regulatory changes. *Id.* The panel, however, did not give the parties any additional opportunity to address the sufficiency of the evidence before the court, such as it was.

On September 25, 2000, eleven years after Adarand lost its bid for the West Dolores guardrail contract, the panel issued its decision. Based on Appendix A—the putative evidence composed by Respondents' attorneys that the panel referred to as *"The Compelling Interest,"* Pet. App. 31, 34—the panel held the District Court had erred in granting summary judgment to Adarand. Pet. App. 1, 79. First, despite this Court's holding regarding Adarand's standing in this case, the panel declined to consider some elements of the challenged regime.[2] Then the panel found that the compelling interest of remediating race discrimination was supported by the "strong basis in evidence" presented to it only in summary form composed by Respondents' attorneys in direct response to previous rulings in this case. Pet. App. 54. Next, the panel found that the particular manner in which the bonus was paid to Mountain Gravel was not narrowly tailored. Pet. App. 79. Finally, the panel found DOT had rectified this one constitutional deficiency through regulatory changes. Pet. App. 58-60. On March 26, 2001, this

[2] The panel found Adarand had standing to challenge 15 USC § 637(d)(1-3) and § 1101(b) of TEA-21. The panel denied standing to challenge 15 USC §§ 637(a), 644(g), and 637(d)(4-6). Pet. App. 14.

Court granted *certiorari* to consider whether this race-based statutory regime survives proper strict scrutiny.

C. Statutory Regime

The statutory heart of this case is the provision of TEA-21 that mandates: "Except to the extent that the secretary determines otherwise, not less than ten percent of the amounts made available" for federal highway construction "shall be expended with small business concerns owned and controlled by socially and economically disadvantaged individuals." TEA-21, Pub L. 105-178, § 1101(b)(1), Pet. App. 300.[3] "DBE" is simply a shorthand designation for "a small business concern owned and controlled by socially and economically disadvantaged individuals." 49 CFR § 26.5 (2000) (cited regulations reproduced in appendix hereto). Implementation of this key provision requires four steps. First, the term "DBE" requires definition. Second, there must be procedures whereby businesses become certified as DBEs. Third, the Secretary must determine whether to use the goal Congress provided in TEA-21 or some other goal. Finally, there must be some machinery for achieving the chosen goal.

1. Definitions

TEA-21 adopts the definition of "socially and economically disadvantaged individuals" from "section 8(d) of the Small Business Act (15 USC § 637(d)) and relevant subcontracting regulations pursuant thereto." § 1101(b)(2)(B), Pet. App. 300. The "relevant subcontracting regulations" are in 13 CFR Part 124, where the Small Business Administration defines "social disadvantage"

[3] The DBE participation provision of TEA-21 applies in this case because the Central Federal Lands Highway Division (CFLHD) let the West Dolores prime contract. Pet. App. 203, 211. CFLHD is a division of DOT and is funded through TEA-21. *Id.*, § 1101(a)(8).

and "economic disadvantage." Pet. App. 205. As required by TEA-21, DOT adopted these SBA definitions and reiterated them "with minor modifications" in Appendix E to 49 CFR Part 26.

Under both SBA and DOT regulations, full "disadvantaged" status depends in the first instance on "social disadvantage"; one cannot be economically disadvantaged unless one is also socially disadvantaged. 13 CFR § 124.103 (2001); 49 CFR Part 26, App. E (2000). "Economically disadvantaged individuals" are:

> socially disadvantaged individuals whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities as compared to others in the same or similar line of business who are not socially disadvantaged.

13 CFR § 124.103 (2001); 49 CFR Part 26, App. E (2000).[4] Because DBEs seek to enter the highway construction business, the necessary "others in the same or similar line of business" must also be in the highway construction business. *See Id.* "Socially disadvantaged individuals," in turn, are:

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[4] In addition, to qualify as economically disadvantaged one's net worth, excluding the value of one's home and business, must be less than three quarters of a million dollars. 49 CFR § 26.67(a)(2)(iii), (d); 13 CFR § 124.104(c)(2). This requirement is both nonsensical and irrelevant, however. It is nonsense because it is easily evaded. Any aspiring entrepreneur could meet the standard by shifting assets into her home or business, thereby excluding those assets from consideration. The requirement is largely irrelevant because as revealed by an SBA report to Congress in 1995, based on Federal Reserve Board data, 92% of American families would qualify under this standard even if the entire family's net worth were included. *The Small Bus. Admin.'s Minority Bus. Development Program, Hearings Before the Senate Cmte. on Small Bus.*, 104th Cong. 42 (1995).

> those who have been subjected to racial or ethnic prejudice or cultural bias within American society because of their identities as members of groups and without regard to their individual qualities.

13 CFR § 124.103 (2001); 49 CFR Part 26, App. E (2000). Evidence of social disadvantage "must include," at a minimum, "[p]ersonal experiences of substantial and chronic social disadvantage in this American society, not in other countries." *Id.* It must also include "[n]egative impact on entry into or advancement in the business world because of the disadvantage." *Id.*

Reading these requirements together, it is apparent that to be considered both socially and economically disadvantaged for purposes of DOT DBE certification, at the very least one must have tried to do highway construction business in America. Furthermore, that attempt must have been hindered in some way by racial discrimination. By definition, persons who never made such an attempt, or who made an attempt but were not hampered by racial discrimination, cannot be socially and economically disadvantaged. They therefore cannot qualify for DBE certification.

2. Certification Procedures

An applicant may obtain DBE certification directly from either DOT or SBA, 49 CFR § 26.67(c) (2000); or from state and local recipients of DOT financial assistance, 49 CFR § 26.83(e) (2000); or from a private certifier qualified by the Small Business Administration, 13 CFR § 124.1002(a) (2001).[5] All of these certifying entities must

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[5] In November 1999, SBA and DOT signed a Memorandum of Understanding (MOU) intended to "identify reciprocal certification principles and streamline procedures for expediting the certification requirements of SBA regulations (13 CFR [P]art 124) and DOT regulations (49 CFR [Part] 26)." *See* 66

use the same basic process, the mandatory elements of which are detailed in 49 CFR § 26.83 (2000). Section 26.83 requires any eligible firm seeking DBE certification to submit an application, made under oath, and requires the certifying agency to investigate the truth of statements made in that application. Though the definition of disadvantage requires that racial prejudice hampered the applicant owners' attempt to enter the highway construction business in America, DOT does not require women and members of preferred races to make any such showing. For women and preferred races, as mandated by TEA-21, DOT simply presumes both prerequisites are met.[6] Section 8(d) of the SBA, from which TEA-21 adopts the definitions of disadvantage, commands:

> The contractor shall presume that socially and economically disadvantaged individuals include Black Americans, Hispanic Americans, Native Americans, Asian Pacific Americans, and other minorities. . . .

15 USC § 637(d)(3)(C), Pet. App. 307. TEA-21 expands that presumption to include women as well. Pub. L.

Fed. Reg. 23208, 23209 (May 8, 2001). The MOU is available on the internet at http://osdbuweb.dot.gov/business/legislation/mem.html. Newly proposed revisions to 49 CFR Part 26 will implement the provisions of the MOU. 66 Fed. Reg. 23208, 23209 (May 8, 2001).

[6] Paradoxically, despite that the statute commands DOT to "presume" disadvantage, DOT regulations now provide that the certifying entity "must require applicants to submit a signed, notarized certification that each presumptively disadvantaged owner is, in fact, socially and economically disadvantaged." *See infra*, Part III.A.1. In practice this requirement literally means nothing more than checking a box on a form and signing the form in the presence of a notary. *See* Disadvantaged Business Enterprise Program Uniform Certification Application, 66 Fed. Reg. at 23221. The regulations also require an essentially meaningless "signed, notarized statement of personal net worth" for each owner. 49 CFR § 26.67(a) (Oct. 1, 2000); *Infra*, n.4.

105-178 § 1101(b)(2)(B), Pet. App. 300. These presumptions are inescapable in the present case because in the direct procurement DBE program at issue, DOT is "the contractor."

Accordingly, every single legally admitted permanent resident or citizen of the United States who happens to be female or who can trace his origins to any of 42 specifically designated countries is automatically presumed to have attempted to enter the American highway construction business and to have experienced racial prejudice that somehow hindered that attempt. 49 CFR § 26.5 (2000). These countries include such economically distinct places as Japan, a G-7 economy, and Tuvalu, an equatorial nation consisting of ten thousand people living on less than 450 square miles of coral atolls.[7] CIA, *World Fact Book* 508-509 (2000). Men of other racial groups with more nebulous boundaries—such as "persons having origins in any of the Black racial groups of Africa" and persons of "Portuguese culture"—are likewise statutorily entitled to this presumption. 49 CFR § 26.5 (2000). DOT regulations provide that these presumptions are "rebuttable," but provide no guidance whatsoever on what evidence would be sufficient to rebut the presumption of social disadvantage. *Id.*; 49 CFR § 26.87(a)(2) (2000) (mandating only that the officer "must review . . . available information").[8]

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[7] Since 1997, "persons whose origins are from . . . Juvalu" has been listed as a racial group entitled to the presumption of social and economic disadvantage. 62 Fed. Reg. 29548 (May 30, 1997); 49 CFR 26.5 (1999). "Juvalu," however, does not exist and never has. The drafters undoubtedly meant "Tuvalu," 57 Fed. Reg. 58288 (Dec. 9, 1992), which has become renowned in recent months by selling rights to the use of its internet domain name suffix ".tv." It is telling that in all the regulatory mutations since this Court's 1995 ruling in this case and despite the recent press, DOT has never corrected this sizable error.

[8] The burden of proof, furthermore, remains on the non-preferred races regardless of the stage of the certification process. Members of non-preferred races bear the burden of

On the other hand, persons "not presumed to be socially and economically disadvantaged," meaning men of non-preferred races, must prove their disadvantage. "In such a proceeding the applicant firm has the burden of demonstrating . . . by a preponderance of the evidence" that its owners at least tried to enter the highway construction business in America but were somehow stymied by racial prejudice against them. 49 CFR §§ 26.63(b)(1), 26.67(d) and App. E (2000). More specifically, when the applicants are not men of a preferred race, the certifying entity "must require that applicants provide," "in every case," proof of "one objective distinguishing feature . . . such as race." 49 CFR § 26.67(d) (2000). They must also provide proof of "education, employment and business history, where applicable, to see if the totality of circumstances shows disadvantage in entering into or advancing in the business world" because of that racial characteristic. 49 CFR Part 26, App. E.

3. DBE Participation Goal Setting

TEA-21 sets a clear goal of ten percent by value for participation by DBEs in DOT contracting, direct procurement included, but authorizes the Secretary of DOT to revise this goal upward or downward. Pub L. 105-178, § 1101(b)(1), Pet. App. 300. Current law mandates that while recipients of DOT financial assistance must have regional DBE participation goals, 64 Fed. Reg. 5096, 5109 (Feb. 2, 1999), for DOT direct procurement purposes the goals are set on a contract-by-contract basis, 48 CFR

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proof in asserting their own disadvantage, 49 CFR § 26.61, and to the extent they may challenge such status at all, *see* 49 CFR § 26.87, members of non-preferred races also bear the burden of proof in challenging the disadvantaged status of another firm. Realistically, small family owned businesses cannot devote the necessary resources to such a challenge, especially since the necessary information is in the hands of other parties, like DOT.

§ 19.7. Specifically, SBA § 8(d) and the applicable Federal Acquisition Regulations ("FAR") mandate that prime contractors bidding on DOT direct procurement projects, with certain exceptions, must submit "an acceptable subcontracting plan," or else "be ineligible for award" of the prime contract. 15 USC § 637(d)(4)(B); 48 CFR § 19.702(a)(1). The required subcontracting plan "must include separate percentage goals for using . . . small disadvantaged businesses . . . as subcontractors." 15 USC § 637(d)(6); 48 CFR § 19.704(a). The DOT contracting officer in charge of letting the contract then "must review the subcontracting plan for adequacy, ensuring that the required . . . goals . . . are included" and are sufficiently high. 48 CFR § 19.705-4; 15 USC § 637(d)(4)(D). The primary criterion for assessing the sufficiency of the goals is that they must manifest the "maximum practicable" use of DBE subcontractors. 15 USC § 637(d)(4)(D). It cannot be discerned from the statutes or regulations what percentage of subcontract value would represent the "maximum practicable use" of DBEs on any given contract.

4. DBE Participation Goal Achievement

There are two means of achieving DBE goals in direct DOT procurement: coercion and incentive. The coercive means, or stick, is mandatory: an accepted DBE subcontracting plan must be rendered "a material part of the contract" and if the "contractor fails to make a good faith effort" to achieve the plan, then "liquidated damages shall be paid by the contractor" in an amount equal to the shortfall. 15 USC §§ 637(d)(4)(F), (d)(8); 48 CFR §§ 19.705-5(a)(5), 19.705-7, 19.707(b)(2) (2000). There are three incentives, or carrots: "price evaluation adjustments," "evaluation factors" and "monetary subcontracting incentive clauses." 15 USC § 637(d)(4)(E); 48 CFR § 19.201. A price evaluation adjustment artificially inflates the bid prices of all bids other than those by DBEs so that DBEs' bids are more likely to be lowest. 48 CFR Subpart 19.11 (2000). An evaluation factor adds extra

points to the bid evaluation score for a prime contract bid. The number of extra points awarded is proportionate to the size of the included DBE subcontracting goals, so that prime contract bidders enhance their chances of winning by pledging to hire more DBEs than their competitors. 48 CFR § 19.1202 (2000). Monetary subcontracting incentives provide for bonus payments to prime contractors that hire DBE subcontractors.[9] 48 CFR § 19.1203 (2000). A monetary subcontracting incentive gave rise to this case. Pet. App. 207-08; Defendants' Answers to Plaintiffs Second Set Of Interrogatories 2, Feb. 7, 1991. All three incentives are only permissible in states where the United States Department of Commerce ("DOC") determines that minority contractors are underutilized in highway construction. 48 CFR § 19.201(b). Pursuant to DOC's most recent determinations, incentives may be used to increase DBE participation in highway construction only in Alabama, Mississippi, Louisiana, Arkansas, Kentucky, Tennessee, Texas, and Oklahoma. 64 Fed. Reg. 52806 (Sept. 30, 1999); 63 Fed. Reg. 54161 (Oct. 8, 1998). Consequently, only the coercive means of achieving DBE participation is available for direct procurement contracts in other states, such as Colorado, Adarand's area of operations.

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[9] The DOT contracting officer "may encourage increased subcontracting opportunities" for DBEs by placing a clause in the contract "substantially the same as the following":

> If the Contractor exceeds its total monetary target for subcontracting to small disadvantaged business concerns in the authorized, NAICS Industry Subsectors, it will receive ___ [*Contracting Officer to insert the appropriate number between 0 and 10*] percent of the dollars in excess of the monetary target. . . .

48 CFR §§ 19.1203, 19.1204, 52.219-26 (1999).

D. Misconceptions

Before analyzing whether this statutory regime survives proper strict scrutiny, it is necessary to dispel two misconceptions that have plagued this case for years. First, it must be understood that Adarand's challenge is not limited to the use of the DBE hiring bonus. DOT has repeatedly invited the courts to limit the scope of this case to the monetary subcontracting incentive in the West Dolores contract, called the "subcontractor compensation clause" or "SCC." *E.g.*, Brief In Opposition to Petition for *Certiorari* ("Opp.") 4. The Tenth Circuit accepted DOT's invitation. Pet. App. 3. In reality, however, Adarand's first Complaint and its Amended Complaint both sought "a judgment that [the challenged statutes], the regulations promulgated thereunder *and* the contract provisions" are unconstitutional. Reply App. 4-9 (emphasis added). Guided by this Court's instructions on remand, the District Court below found that Adarand had challenged the applicable statutes and regulations as well as the SCC in the West Dolores contract. Pet. App. 160-61. According to this Court's April 13, 2001 order in this case, moreover, the issue presented is the constitutionality of "[DOT's] current Disadvantaged Business Enterprise program," not the constitutionality of the putative "SCC program." Thus, because Adarand seeks prospective relief, the scope of this case includes all of the statutory definitional underpinnings, goal setting, and goal achievement mechanisms that gave rise to the terms of the West Dolores contract and thereby caused Adarand harm. Appropriate taxonomy is crucial for proper implementation of this Court's decision in this case.

Next, it must be acknowledged that DOT has two different DBE programs and that the panel analyzed the workings of the wrong one. This Court's April 13 order requires the parties to address DOT's DBE "program," singular. In reality, however, DOT has one DBE program for federal financial assistance to state and local agencies, and another, separate DBE program for federal highway

contracts let directly by DOT. As this Court found in 1995, this case involves only the latter. The West Dolores contract was one of 14 prime contracts in Colorado that the CFLHD awarded directly to prime contractors between 1983 and 1990. Pet. App. 203, 211. In this case, the necessary definitions and certification procedures for both programs are found in 49 CFR Part 26. Other than the provisions that define basic terms and provide procedures for DBE certification, however, 49 CFR Part 26 is inapposite.[10] Nevertheless, both the panel and DOT have relied extensively on inapplicable provisions of Part 26. For example, in its narrow tailoring analysis the panel quoted 49 CFR § 26.51 for the rule that prime contractors hired by recipients of DOT financial assistance must meet the maximum feasible portion of their DBE goal through race-neutral means. Pet. App. 59. There is no such recipient in this case. Proper strict scrutiny must therefore be

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[10] Only the definitional and certification provisions of 49 CFR Part 26 apply in this case because Part 26 "affects only the airport, transit and highway financial assistance programs of the [US Transportation] Department," 62 Fed. Reg. 29548, 29549 (May 30, 1997), and no such financial assistance is involved here. The first goal of Part 26, by its own terms, is "[t]o ensure nondiscrimination in the award and administration of DOT-assisted contracts in the Department's highway, transit and airport financial assistance programs." § 26.1(a) (2000). In a section entitled "To whom does this part apply?," Part 26 plainly states, "if you are letting a contract in which DOT financial assistance does not participate, this part does not apply to the contract." 49 CFR § 26.3(d) (2000). Instead, Part 26 only "concerns the state and local, rather than the federal, procurement actions." 62 Fed. Reg. at 29549. Since this case concerns federal procurement, not financial assistance, the applicable components of Part 26 are § 26.5 of Subpart A, all of Subpart D (§§ 26.61-73), sections 26.83 to 26.91 of Subpart E, § 26.107 of Subpart F, and all of Appendix E. The inapposite components are sections 26.7 to 26.15 of Subpart A, all of Subparts B and C (§§ 26.21-55), § 26.81 of Subpart E, and all of Appendices A, C, and D (there being no Appendix B).

based on the goal setting and achievement provisions of 48 CFR Part 19, not 49 CFR Part 26.[11]

SUMMARY OF THE ARGUMENT

In the two decades since this Court again held in *Fullilove v. Klutznick*, 448 US 448 (1980), that racial preferences are constitutional under certain circumstances, racial preferences have taken on the very attributes this Court dreaded most. Therefore, at least for government contracting, this Court should return to the ideal expressed in dissent in *Plessy v. Ferguson*, 163 US 537 (1896), that racial preferences, in any direction and under any circumstances, are intolerable, always.

Even if this Court once again holds that racially discriminatory laws are permissible under some circumstances, this Court must find that those circumstances are not present in this case. As an initial matter, the panel misapplied the strict scrutiny test by violating basic rules of evidence and procedure. By accepting Appendix A as competent evidence, moreover, the panel misapplied the compelling interest test. First, to justify the DBE program, DOT must produce a strong basis in evidence that racial discrimination, as opposed to some other consideration, caused disparity in minority participation in highway contracting. The panel failed to investigate causation. Then the panel failed to consider whether Congress had

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[11] 48 CFR Part 19—the FAR—establishes "the respective roles of the executive agencies [like DOT] and Small Business Administration" in implementing federal direct procurement programs, including goal setting. 48 CFR § 19.000(a)(2) (2000). The FAR "implements the acquisition-related sections of the Small Business Act." 48 CFR § 19.000(a) (2000). This Court recognized that the FAR applies in this case when it noted that the SCC itself originated in 48 CFR Part 19, not 49 CFR Part 26. Pet. App. 205 ("the [SBA] program confers a wide range of benefits on participating businesses, see, *e.g.*, . . . 48 CFR subpt. 19.8 (1994), one of which is automatic eligibility for subcontractor compensation provisions").

the necessary evidence *before* it enacted TEA-21. That evidence should have included, for example, a demonstration of the existence of racial discrimination in highway construction contracting in at least a majority of states. By the federal government's own reckoning, however, in 42 out of 50 states there is not even a disparity in minority participation. Also by the government's own reckoning, the information required to form a strong basis in evidence is still not available because Congress and DOT have not yet collected it.

The panel misapplied the narrow tailoring test by finding that a mandatory presumption of disadvantage is not overinclusive. It also misapplied the test by finding that a racially discriminatory highway construction contracting program was a sufficiently focused, last resort solution for, *e.g.*, discrimination in union membership or difficulties in capital access. Finally, the panel misapplied the test by finding that this decades-old, still-expanding DBE program is of appropriately limited duration. If Appendix A is a sufficient basis for the program, then the program could go on forever.

ARGUMENT

I. This Court Should Adopt The Harlan Doctrine And Hold That There Can Never Be A Compelling Interest In Preferential Treatment Of Racial Groups In Government Contracting.

When defeated survivors of the Civil War still ruled the South, this Court held in *Plessy v. Ferguson* that it was permissible under certain circumstances for government to discriminate on the basis of race. 163 US 537 (1896). Justice Harlan saw farther. In dissent, he declared:

> Our Constitution is color-blind, and neither knows nor tolerates classes among citizens. In respect of civil rights, all citizens are equal before the law. The humblest is the peer of the most powerful. The law regards man as man,

> and takes no account of his surroundings or of his color when his civil rights as guarantied by the supreme law of the land are involved. It is therefore to be regretted that this high tribunal, the final expositor of the fundamental law of the land, has reached the conclusion that it is competent for a state to regulate the enjoyment by citizens of their civil rights solely upon the basis of race.

Id. at 559. Later, in the heat and confusion of World War II, this Court again pronounced that under certain circumstances it is permissible for the American government to discriminate on the basis of race. *Korematsu v. United States*, 323 US 214, 216 (1944). Ten years later, at the dawn of the civil rights movement, this Court finally recognized that Justice Harlan was correct in so far as *Plessy v. Ferguson* was wrongly decided, but the Court stopped short of holding all racial discrimination by government unconstitutional. *Brown v. Board of Educ.*, 347 US 483 (1954).

When the Court thus left the door open, legislatures all over the country barged through it. Legislatures large and small, including the United States Congress, continued to attempt to generate the necessary circumstances under which they could constitutionally discriminate against certain races.[12] In the attempt, they trampled the

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[12] For purposes of this argument, Adarand will not distinguish among categorization by race, ethnicity, linguistic heritage, geographic origin, and direct familial lineage (blood group). For the sake of simplicity, Adarand herein refers to all such categorizations as "racial." *Cf. Concrete Works v. City and County of Denver*, 86 F.Supp.2d 1042, 1069 (D. Colo. 2000) ("One group is defined by race, another by culture, another by country of origin, and other by blood. . . . The aggregation of them as equally victimized by discrimination and equally entitled to preferential remedies is particularly problematic") (*appeal stayed* pending resolution of this case); *Rice v. Cayetano*, 528 US 495, 120 S.Ct. 1044, 1061 (2000) (Breyer, J., with Souter, J., concurring)

constitutional rights of countless innocent individuals. As this Court feared, after fifty years of such attempts, "there is simply no way of determining what classifications are . . . 'remedial' and what classifications are in fact motivated by . . . simple racial politics."[13] 488 US at 493. The dream of a society where race is irrelevant has become "lost in a mosaic of shifting preferences based on inherently unmeasurable claims of past wrongs"[14] committed by persons other than those who suffer in

("to define . . . membership [in a preferred blood group] in terms of 1 possible ancestor out of 500, thereby creating a vast and unknowable body of potential members . . . goes well beyond any reasonable limit").

[13] Racial politics are glaringly evident in the debates regarding whether to again perpetuate the DBE program by passing the discriminatory provisions of TEA-21. Rep. Schuster, Chairperson of the House Committee on Transportation and Infrastructure and sponsor of the bill, candidly admitted that he supported perpetuation of the DBE program only because he "made an agreement to oppose any DBE reforms in exchange for a balanced bipartisan bill that provides maximum funding. . . . " 144 Cong. Rec. H2000-H2011, H2001 (April 1, 1998). Senator Chaffee, Chair of the Senate Public Works Comm., pointed out that President Clinton had promised to veto the bill if it contained no DBE program, but that "[every] single Senator in this place" wanted his or her district's share of the $150 billion dollars TEA-21 provided. 144 Cong. Rec. S1395-S1434, S1411 (March 5, 1998). Representatives Norton and Bonior threatened that "hundreds of thousands" of women and minorities would not reelect anyone who voted to end the DBE program. H2003-04. Reps. Tausher and Poshard and Senators Warner and Kennedy all fretted that the program is already in place, employs many minorities, and would result in economic loss to those people if it ended. H2002; S1401, 1409.

[14] For example, the President of the National Association of Black Manufacturers testified, "[t]he only true claim to being socially and economically disadvantaged . . . excludes all but Black Americans . . . and the Native Americans," *Testimony Before The House Comm. on Small Businesses, Subcomm. on Gen. Oversight and Minority Enter. Task Force on Minority Enter.*, 96th

penance. *Id.* at 505-06. Not even all those entitled to benefit from racial preferences believe they are sound public policy. Instead, they "stigmatize [their] recipient groups," *see United Jewish Organizations v. Carey*, 430 US 144, 173-74 (1977) (Brennan, J., concurring in part), and erode individuals' ability to be judged on their individual talents and contributions alone, *see Goode v. City of Austin*, 202 F.3d 265 (5th Cir. 1999) (table), *cert. denied*, 120 S.Ct. 1996 (2000) (African-American entrepreneur sued food service corporation after his refusal to register as a DBE caused corporation to terminate his vendor contract; standing denied).

Thus, despite fifty years of carefully contrived, deliberate, governmental discrimination, this Court has never allowed any such scheme to pass constitutional muster. This result is to be expected. After all, the Court in *Korematsu* seemingly envisioned that only the most dire of needs, such as "the prevention of espionage and sabotage" in time of global war, could form a compelling interest in racial discrimination by government. Nevertheless, a century after Justice Harlan first proposed the doctrine that all races must always be equal under the law, this Court again declared, in this very case, that there might, someday, be a sufficiently compelling interest to justify racial discrimination in government contracting. Pet. App. 242. It is now time to end this experiment, however well intended it may have been. This Court should adopt the Harlan Doctrine as law, at least as to government contracting.

The Harlan Doctrine should apply in government contracting, at least, because the only possible justification for racial preferences in contracting is unavailable.

Cong. 21 (1979). Norman Mineta, however, Respondent in this case and, at the time, one of California's Representatives in Congress, proposed an amendment extending the presumption to Asians—a large voting block in that state. 125 Cong. Rec. 12082 (1979).

The only possible justification for deliberate governmental racial discrimination in contracting is that racial preferences are required as a last resort effort to "remedy private discrimination," *City of Richmond v. Croson*, 488 US 469, 509 (1989). No other justification, such as pursuit of cultural diversity, will suffice. There can be no reason a person's heritage could be expected to enhance the installation of a guardrail, for example. The "last resort" justification is unavailable in contracting because even in the absence of racial preferences, a low bidder will always have a remedy for discrimination: a lawsuit. If a subcontractor submitted the low bid but did not win, remedy for suspected discrimination is to be found in laws that prohibit discrimination, not in preordained discrimination against innocents. Prophylactic devices for protection against discriminatory selection of bidders could include broadcasting all contracting opportunities. Means of exposing potential discriminators might include mandatory post-award publication of all bids received.

In practice, the Harlan Doctrine means that the government has the solemn obligation to prohibit race discrimination, and the discretion, toward that end, to invoke prophylactic devices that themselves are not discriminatory. *See, e.g., Kimel v. Fla. Bd. of Regents*, 528 US 62, 120 S.Ct. 631, 648 (2000) (Congress may enact "reasonably prophylactic legislation."). The Doctrine also means, however, that not even Congress has the power to compel race discrimination by American citizens.[15] The Harlan

[15] Section 5 of the 14th Amendment provides special dispensation for Congress to pass laws that would otherwise violate the 10th and 11th Amendments, but provides no special dispensation for Congress to violate the equal protection component of the 5th Amendment or the Equal Protection Clause of the 14th Amendment. *See United States v. Morrison*, 529 US 598, 120 S.Ct. 1740, 1755 (2000) ("limitations on the manner in which Congress may attack discriminatory conduct" under § 5 of the 14th Amendment "are necessary to prevent the Fourteenth Amendment from obliterating the Framers' carefully crafted balance of power between the States and the National Government"). Section 5 allows Congress to *prohibit* actions by states that would otherwise be constitutional; it does not allow Congress to *mandate* activities that would otherwise be *un*constitutional. *See Morrison*, 120 S.Ct. at 1759. There is no authority whatsoever for the contrary proposition. Although this Court cited *United States v. Paradise*, 480 US 149, 167 (1987) for the proposition that "every Justice of this Court agreed that the Alabama Department of Public Safety's 'pervasive, systematic, and obstinate discriminatory conduct' justified a narrowly tailored race-based remedy," Pet. App. 242, that remedy was not devised by Congress legislating generally and without factual predicate. Quite on the contrary, the remedy in *Paradise* was devised by a federal court and imposed upon a single organization on the basis of highly detailed factual findings.

Doctrine recognizes that it is simply impossible to engineer a "society where race is irrelevant to personal opportunity" by deliberately injecting race into decision making and firmly ensconcing racist stereotypes in the law. *See* 488 US at 505.

II. The Panel Misapplied The Compelling Interest Test By Finding That DOT Had Met Its Burden Of Production Of A "Strong Basis In Evidence" That Race Discrimination Caused Racial Disparity In Highway Construction In At Least A Majority Of States.

This case comes before this Court for the third time on cross motions for summary judgment. Summary judgment is appropriate where there is no genuine issue of material fact. Fed. R. Civ. Pro. 56. As this Court decided in this very case, moreover, "the government bears the burden of proving that the DBE program is constitutional." *In re Sherbrooke Sodding Co.*, 17 F.Supp.2d 1026, 1033 (D. Minn. 1998) (*citing*: *Adarand*, 515 US at 223; *United States v. Virginia*, 518 US at 533).[16] As evidence,

[16] Even if the burden of proof rests with Adarand, this analysis remains the same. Likewise, this analysis would not

Respondents submitted only Appendix A, and the panel relied on it exclusively. Specifically, the panel took "judicial notice of the content of hearings and testimony before the congressional committees and subcommittees cited by the government" such that "the disparity studies were . . . introduced into evidence . . . via [Appendix A]."[17] Pet. App. 33-34 & n.12, 47 n.14, 54. The panel refused to uphold summary judgment for Adarand because, in the panel's view, by producing Appendix A Respondents had presented a sufficiently strong basis in evidence of the necessary facts, but Adarand had failed to

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change if this case concerned DOT state and local financial assistance instead of direct procurement. Regardless of who has the ultimate burden of persuasion, and no matter who let the West Dolores contract, it is clear that DOT bears the burden of producing a strong basis in evidence. *Walker v. City of Mesquite*, 169 F.3d 973, 982 (5th Cir. 1999), *cert. denied*, 120 S.Ct. 969 (2000). DOT cannot meet that burden.

[17] It is obvious that the panel relied exclusively on the text of Appendix A, not the studies Appendix A purports to summarize. To illustrate, the panel quotes Appendix A for the allegation that minority subcontracting firms "still receive only 87 cents for every dollar they would be expected to receive." Pet. App. 45. Published in 1996, Appendix A itself relied for that proposition on a study by the Urban Institute that was not yet finished. 61 Fed. Reg. 26061 n.128 ("To date, UI has evaluated 56 [state and local disparity] studies"). UI completed and most recently published that study in December 1997, well over two and half years before the panel decided this case. Enchautegui, Maria E. *et al., Do Minority Owned Businesses Get a Fair Share of Government Contracts?* The Urban Institute (www.urban.org/authors/enchautegui.html). When finished, UI had evaluated nearly double the number of studies indicated in Appendix A and had concluded that there was no statistically significant underutilization of minority construction subcontractors in the aggregate. *Id.* at 15 and n.6. Further, the UI report plainly states that whatever disparities it did detect "do not necessarily translate into proof of discrimination on the part of state and local governments." *Id.* at xiv.

produce sufficient countervailing evidence to create a genuine issue for trial. Pet. App. 53.

As an initial matter, the panel misapplied the strict scrutiny test by accepting Appendix A as evidence sufficient for summary judgment purposes. Appendix A is not sworn testimony given from personal knowledge.[18] The panel also misapplied the strict scrutiny test by taking judicial notice of Appendix A. To do so was tantamount to "blind judicial deference to legislative or executive pronouncements of necessity," which this Court unequivocally found "has no place in equal protection analysis."[19] *Croson*, 488 US at 500-501. Even if Appendix A

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[18] Pursuant to Federal Rule of Civil Procedure Rule 56(c) and (e), summary judgment evidence must be in the form of admissions, depositions, answers to interrogatories, affidavits, or other sworn testimony. *Celotex v. Catrett*, 477 US 317, 324 (1986). Appendix A is not. Competent summary judgment evidence also "shall be made on personal knowledge [and] shall set forth such facts as would be admissible in evidence. . . . " Fed. R. Civ. P. 56(e). Appendix A was prepared by Respondents' attorneys in direct response to this case, but not from their personal knowledge, and is composed of hearsay used for the truth of the matter asserted, which therefore would be inadmissible. Fed. R. Evid. 802, 805; *F. Buddie Contracting, Ltd. v. Cuyahoga Community College Dist.*, 31 F.Supp. 571, 582 (N.D. Ohio 1998) (granting summary judgment striking minority preference challenge in part because "the studies [were] not authenticated by anyone with personal knowledge and, thus, [were] inadmissible hearsay").

[19] Judicial notice of the content of Appendix A runs afoul of Federal Rule of Evidence 201. That rule forbids judicial notice of adjudicative facts that are not "capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned." Appendix A is comprised of adjudicative facts that are obviously incapable of such ready determination. *Qualley v. Clo-Tex Intern., Inc.*, 212 F.3d 1123, 1128 (8th Cir. 2000) (to qualify as legislative fact, instead of adjudicative facts, the facts must be "wholly unrelated to the activities of the parties"); *United States v. Wolny*, 133 F.3d 758,

were cognizable, probative evidence, moreover, the panel misapplied the strict scrutiny test by finding that Appendix A comprised the requisite "strong basis in evidence" sufficient to support a compelling interest.

It is beyond dispute that the use of a racial classification by a governmental actor must be supported by a "strong basis in evidence" of a compelling governmental interest in remedying particularized discrimination in which that government somehow participated. Pet. App. 224; *Croson*, 488 US at 500. Given that the asserted compelling interest is always "remedying past or present discrimination," however, "the true test of an affirmative

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764 (10th Cir. 1998) (adjudicative facts do not "apply universally," but rather, "change from case to case"); *United States v. Gould*, 536 F.2d 216, 219 (8th Cir. 1976) (adjudicative facts concern "who did what, where, when, how and with what motive or intent"). *See, e.g., Assoc'd Gen. Contractors of Ohio v. Drabik*, 214 F.3d 730 (6th Cir. 2000) (litigation regarding validity of allegations like those contained in Appendix A); *Webster v. Fulton County*, 51 F.Supp.2d 1359 (N.D. Ga. 2000), *aff'd*, 218 F.2d 1276 (11th Cir. 2000) (same); *Engineering Contractors of S. Fla. v. Metropolitan Dade County*, 943 F.Supp. 895 (S.D. Fla. 1996), 122 F.3d 895 (11th Cir. 1997) (same); *Contractors Association of Eastern Pennsylvania v. City of Philadelphia*, 893 F.Supp. 438 (E.D. Pa 1995), 91 F.3d 586 (3rd Cir. 1996) (same); *O'Donnell Constr. Co. v. District of Columbia*, 963 F.2d 420 (D.C. Cir. 1992) (same). Even if Appendix A contained legislative facts, judicial notice of them was an abuse of discretion requiring reversal. *See Multnomah Legal Services Workers Union v. Legal Services Corp.*, 936 F.2d 1547, 1555 (9th Cir. 1991) (reversing for abuse of discretion when district court "took judicial notice of several post-enactment Congressional statements, including Senate Appropriations Committee reports"); *Cf. Koohi v. United States*, 976 F.2d 1328, 1330 n.1 (9th Cir. 1992) (taking judicial notice of "the basic events surrounding the Iran-Iraq conflict . . . to the extent that they are . . . beyond reasonable dispute" but declining to take judicial notice of the content of "former Secretary of Defense Casper Weinberger's *A Report to the Congress on Security Arrangements in the Persian Gulf* (June 15, 1987)").

action program is . . . the adequacy of the evidence of discrimination offered to show that interest." *Engineering Contractors*, 122 F.3d at 906.

In this case, relying exclusively on the content of Appendix A, the panel concluded the following findings comprise the requisite strong basis in evidence:[20]

- The tendency of company owners to pass ownership of their companies to members of their families instead of members of minority groups, Pet. App. 34-35;
- The difficulty people with no experience have in joining a union in order to gain the experience needed to compete with established non-minority companies, Pet. App. 35;
- The difficulty of obtaining access to capital in the absence of a credit history or collateral, Pet. App. 35;
- The tendency of prime contractors to work with subcontractors they already trust because they have worked with those subcontractors before, Pet. App. 39-40;
- "Bid shopping," a practice by which prime contractors allow trusted former subcontractors to see and beat any lower bid from new, untested firms trying to replace those former subcontractors, Pet. App. 40;

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[20] Likewise, the district court in this case found that the problems Congress was trying to remedy were:

> [D]eficiencies in working capital, inability to meet bonding requirements, disabilities caused by an inadequate 'track record,' lack of awareness of bidding opportunities, unfamiliarity with the bidding procedures, preselection before the formal advertising process, and the exercise of discretion by government procurement officers to disfavor minority businesses.

965 F.Supp. at 1576. But then, the district court granted summary judgment to Adarand.

- The inability of new enterprises to obtain bonding because they lack experience, which in turn hinders their ability to gain experience, Pet. App. 41-43; and
- The inability of new market entrants to receive special pricing arrangements from suppliers from whom they have never purchased anything before, Pet. App. 43-44.

In reality, a legally adequate strong basis in evidence must consist of much more. A true strong basis in evidence must be based on logically and mathematically sound means of detecting whether deliberate discrimination caused any observed racial disparity in highway construction contracting. By relying exclusively on Appendix A, the panel precluded itself from performing such inquiries. A true strong basis in evidence for this national DBE program also requires statistical evidence that racial discrimination caused nationwide underutilization of minority contractors. Here, by the federal government's own reckoning, minority highway contractors are not even underutilized in all but eight states and the requisite evidence still does not exist. Finally, it is necessary that Congress had the requisite strong basis in evidence *before* it enacted TEA-21, but Congress, to the extent it made any findings at all, demonstrated impermissible motive and lack of evidence.

A. A Strong Basis In Evidence Must Demonstrate That Race Discrimination Caused Any Observed Racial Disparity In Highway Construction, But The Panel Failed To Investigate Causation.

Although *Croson* teaches that a "gross statistical disparity," if properly derived, can raise an inference of racial discrimination under certain circumstances, indications of disparity alone, however large, cannot suffice as a strong basis in evidence. 488 US at 501. Accordingly, "[i]t is permissible to remedy *discrimination*[; i]t is not

permissible to remedy a *disparity*. . . . " *Middleton v. City of Flint, Michigan*, 92 F.3d 396, 406 (6th Cir. 1996) (italics in original). Moreover, as the panel below correctly recognized, anecdotal evidence of discrimination may be considered only after a determination that the necessary statistical evidence of deliberate discrimination exists. Pet. App. 29. Therefore, in order to conclude that there is strong evidence of a compelling interest, a court must find proper statistical evidence of "deliberate patterns of racial exclusion."[21] *Croson*, 488 US at 492, 500. To be eligible for consideration as a strong basis in evidence, statistical evidence must meet four criteria. The panel misapplied the compelling interest test by failing to inquire whether Appendix A, to the extent it constitutes statistical evidence at all, meets any of them. It does not.

First, statistical evidence must be derived from the proper sample pool. That pool consists of those contractors who not only have the necessary expertise to perform the contracts in question, but who also have met any necessary preconditions -such as bonding requirements and capitalization, and who are not otherwise engaged at the time. *Croson*, 488 US 501-02. This Court called such

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[21] A court must also find evidence that the government participated, at least passively, in any deliberate patterns of racial exclusion it professes to have detected. *Croson*, 488 US at 492, 500. In this case, the panel misapplied the compelling interest test by failing even to look for such evidence. For example, the panel stated that "subcontractors' unions place before minority firms a plethora of barriers to membership," Pet. App. 35, but the panel failed to indicate how government was involved with that discrimination. Such involvement might include, for example, some federal requirement that federal prime contractors may only engage subcontractors who belong to subcontractors' unions. The panel, however, sought no such requirement. Instead, the panel simply decreed, without more, that government passively participates in the alleged discrimination by such unions. That decree is an obvious non-sequitur.

contractors "qualified," "willing and able." *Id.* In the absence of statistical evidence derived from the proper pool, this Court found, any finding of racial animus would rest on only "the completely unrealistic assumption that minorities will choose to enter construction in lockstep proportion to their representation in the local population." *Id.* at 741. In this case, the panel did not even ask whether the statistics it cited from Appendix A were derived from the proper pool of qualified, willing and able contractors.

Second, statistical evidence must contain detailed explanation of the methods by which it was derived. "[A]n expert who supplies nothing but a bottom line supplies nothing of value to the judicial process." *Mid-State Fertilizer Co. v. Exchange Nat'l Bank*, 877 F.2d 1333, 1339 (7th Cir. 1989). Here, the panel merely parroted conclusions without inquiring into methods. For example, the panel recited the statement in Appendix A that "minority firms were nearly twice as likely to be rejected for bonding . . . than white firms with the same experience level," Pet. App. 43, but the panel moved on without noticing that Appendix A contains no discussion whatsoever of how that conclusion had been reached, 64 Fed. Reg. at 26060 & n.199.

Third, "in order for statistical evidence to create an inference of discrimination, the statistics must show a significant disparity and eliminate nondiscriminatory explanations for the disparity . . . [;] . . . statistical evidence *must* focus on *eliminating nondiscriminatory explanations* for disparate treatment between *comparable* individuals." *Fallis v. Kerr-McGee Corp.*, 944 F.2d 743, 746 (10th Cir. 1991) (italics in original). *Accord, Wessmann v. Gittens*, 160 F.3d 790, 804 (1st Cir. 1998); *Koger v. Reno*, 98 F.3d 631, 637 (D.C. Cir. 1996). "*Croson* . . . reaffirmed the Court's longstanding teaching that we must staunchly resist attempts to substitute speculation and correlation for evidence of causation." *Wessmann*, 160 F.3d at 804; *accord, Drabik*, 214 F.3d at 736; *Walker*, 169 F.3d at 985 n.33. Therefore, this Court held, "[t]o draw an inference of

discrimination from statistical disparities, while all 'measurable variables' need not be accounted for, all 'major variables,' must be controlled and accounted for." *Bazemore v. Friday*, 478 US 385, 400 (1986). "[T]he requirement of considering various salient causal factors is part and parcel of [the government's] duty to limn a plausible causal relationship between particular independent and dependent variables." *Wessmann*, 160 F.3d at 834 n.8 (internal citations omitted). One court observed, in fact, that this Court "unanimously held . . . that a regression analysis that does not control for at least major variables may be altogether inadmissible." *Smith v. Virginia Commonwealth Univ.*, 84 F.3d 672, 681 (4th Cir. 1996), *citing Bazemore*, 478 US at 400 & n.10. The panel's most glaring failure in this case was that it made no attempt whatsoever to investigate whether the statistical conclusions it relied on employed judicially acceptable means of accounting for causation, such as proper regression analysis. In thirteen citations of "evidence" that race discrimination caused disparate access to capital, for example, the panel bothered to note whether "all other factors were equal" in only three, and never investigated whether those factors were, indeed, equal. Pet. App. 37-38 (Grown & Bates report, Ando article, CCCD survey).[22] Likewise, the panel made absolutely no effort to ensure that the studies' authors had actually considered some of the relevant major contributory factors, let alone all of them. *Id.*

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[22] The other ten bits of "evidence" on which the panel relied consisted solely of parroting the conclusory statements of self-interested parties made before Congress. Pet. App. 35-38. Lending credence to such statements contravenes this Court's admonition in *Croson* that "highly conclusionary statement[s] of proponent[s] of the Plan that there was racial discrimination in the construction industry . . . are of little probative value in establishing identified discrimination." 488 US 469, 500; *infra*, n.24.

Fourth, the statistics must be collected separately for prime contracts and subcontracts. Since Respondents do not assert that DOT itself is engaged in deliberate discrimination, the basis of DOT's direct procurement DBE program must be passive participation. Unless subcontracting statistics are collected separately, however, it is logically impossible to discern whether government passively participates in discrimination because minority representation in subcontracts could make up for any observed disparity in prime contracts. *W.H. Scott Constr. Co., Inc. v. City of Jackson*, 199 F.3d 206, 218 (5th Cir. 1999). Ordered by Congress to assess the status of DBE participation in DOT contracting (*see infra*, pp.36-37), the United States General Accounting Office ("GAO") reported that "both the number and value of subcontracts awarded to DBEs and non-DBEs" is "information necessary to calculate DBEs' participation rates in subcontracts." GAO, *Report to Congressional Committees: Disadvantaged Business Enterprises, Critical Information Is Needed To Understand Program Impact* 21, June 2001. The panel utterly failed to make this inquiry. GAO, moreover, concluded that no such inquiry is even possible. "Because DBEs are . . . more likely to compete for subcontracts . . . than prime contracts, the lack of subcontracting data prevents anyone from gaining a complete understanding of DBEs' participation in transportation contracting." *Id.* at 21-22.

The panel's failure to investigate whether Appendix A met these four criteria is obvious. To illustrate, Respondents and the panel both relied heavily on Brimmer & Marshall's study of disparities in Atlanta. Pet. App. 43; Resp. 22. Long before they cited that study as "particularly striking" evidence of deliberate discrimination, however, the study had been thoroughly discredited. For example, it contained "no statistical analysis of other factors that may affect minority business enterprise availability and utilization." *Webster*, 51 F.Supp.2d at 1357, 1368-70. In other words, it did not account for causation. The Eleventh Circuit therefore affirmed the district

court's holding that, afflicted with such "insurmountable" flaws, "the Brimmer-Marshall Study fails to provide a strong basis in evidence of discrimination against [D]BEs to justify [a] racial and ethnic preference program." 218 F.3d at 1267.

B. A Strong Basis In Evidence For This Nationwide DBE Program Requires Strong Evidence Of Deliberate Racial Discrimination In Highway Contracting In At Least A Majority Of States, But By The Federal Government's Own Reckoning, There Is Not Even A Disparity In 42 States.

This Court made clear in this very case that DBE programs must be scrutinized, strictly and with "skepticism," for "congruence" between the alleged compelling interest and the racially discriminatory solution. Pet. App. 226. More recently, in *United States v. Morrison*, this Court made clear that congruence requires a match between the geographic area in which government participation in discrimination is found, and the area in which the race-based solution is applied. 120 S.Ct. at 1759. More specifically, when "Congress' findings indicate that the problem of discrimination . . . does not exist in all States," then the solution cannot apply in all states, either. *Id.* This proposition ought to apply with special force in this case because the federal government itself acknowledges that construction is a regional industry. *See* 64 Fed. Reg. 52806 (Sept. 30, 1999). Thus, Congress has the power to direct a remedy for discrimination—*i.e.*, Congress has a compelling interest—"only [in] those States in which Congress found that there had been discrimination." *Id.*; *See Bd. of Trustees of the Univ. of Ala. v. Garrett*, 531 US 356 (2001); *Kimel*, 528 US 62; *Fla. Prepaid Postsecondary Educ. Expense Bd. v. College Savings Bank*, 527 US 627 (1999); *City of Boerne v. Flores*, 521 US 507 (1997). In this case, however, although the mandatory DBE subcontracting provisions apply nationally, DOT and Congress have affirmative

reason to believe there is no nationwide discrimination against minority highway construction companies. As required by 48 CFR § 19.201, the United States Department of Commerce ("DOC") conducted a "benchmark study" seeking underutilization of minority "Street and Highway Construction" companies (SIC code 16). It found no disparity—let alone evidence of intentional discrimination—in 42 out of 50 states.[23] 63 Fed. Reg. 35714 (June 30, 1998); 63 Fed. Reg. 54161 (Oct. 8, 1998). DOC confirmed that result one year later. 64 Fed. Reg. 52806 (Sept. 30, 1999). Furthermore, DOC found no alleged underutilization in Colorado, where this case arose. GAO was even more explicit. Expressly ordered by Congress to assess DBE participation in DOT contracting, *infra*, pp.36-37, GAO's conclusion was unmistakable: "A lack of key information prevents *anyone* from gaining a clear understanding of the firms that participate in the DBE program and how these firms compare with the rest of the transportation contracting community." App. 6 (emphasis added).

[23] In citing the benchmark study, Adarand in no way accepts that the study's methodology or conclusions are valid. Because the methodology is flawed, in fact, the study probably underestimates minority participation levels. Dr. George La Noue, *To the 'Disadvantaged' Go The Spoils*, 138 The Public Interest, Winter, 2000 at 91-98. Even if the study's conclusions are accurate, though, they cannot possibly be characterized as a strong basis in evidence of a compelling interest in a national DBE program because the benchmark study sought only disparity, and expressly disclaims any attempt to find the requisite intentional discrimination. 63 Fed. Reg. at 35718 n.10.

C. A Strong Basis In Evidence Must Demonstrate That Congress Had Compiled The Requisite Evidence *Before* It Enacted TEA-21, But To The Extent Congress Made Any Findings At All, They Show Impermissible Motive And Lack Of Evidence, And By The Federal Government's Own Reckoning, The Requisite Evidence Still Does Not Exist.

This Court has made clear that "a racial classification cannot withstand strict scrutiny based upon speculation about what 'may have motivated' the legislature." *Shaw v. Hunt*, 517 US 899, 908 n.4 (1996). Instead, "the State must show that the alleged objective was the legislature's 'actual purpose' for the discriminatory classification. . . . " *Id.* Therefore, "the institution that makes the racial distinction must have had a strong basis in evidence to conclude that remedial action was necessary *before* it embarks on an affirmative-action program." *Id.* at 910 (emphasis in original); *accord*, *Bush v. Vera*, 517 US 952, 982 (1996); *Croson*, 488 US at 504 (requiring that government actors "must identify that discrimination- . . . with some specificity before they may use race-conscious relief").

In this case, Congress certainly did not rely on the Benchmark Study in passing TEA-21. The results of that study were not published until two weeks after the bill was passed. *Infra* nn.1, 23. Instead, Congress' objective, and the evidence upon which Congress relied, may be found in three sources: 1) express statements of purpose in the statute or in Committee reports describing the statute; 2) inferences drawn from the substantive provisions of the statute; or 3) where no other source is available, from floor statements regarding the statute.[24] As to

[24] Seeking another, more favorable source of Congressional findings and intent, the panel attempted to derive a compelling interest from 23 selected quotes from witnesses appearing before 12 different committee hearings. *E.g.*, Pet. App. 36-37.

TEA-21 however, not one of these sources describes a permissible purpose or shows Congress was operating on the basis of strong evidence. On the contrary, the only available indications of congressional intent show that Congress' motive at the time it passed TEA-21 was impermissible.

First, TEA-21 has no preamble and its extensive accompanying committee reports contain no statement of the purpose of its DBE provisions. *See, e.g.*, H. Rep. No. 105-550 (1998), *reprinted in* 1998 USCAAN Leg. Hist. 3, 82. In fact, the committee reports expressly state that Congress abdicated its responsibility of finding evidence of a compelling interest to the courts. *Id.* (TEA-21 "makes no changes to these [DBE] provisions preferring to let the courts resolve these issues"). These facts alone are sufficient reason to find Congress lacked a compelling interest in passing the program. *See Drabik*, 214 F.3d at 735-36 (noting district court's observation that in all the "drafts of bills, Legislative Service Commission summaries, and transcripts of floor debate, there is not one . . . finding of discrimination to be found" and striking statute because this Court held legislatures are entitled to no deference in equal protection analysis, *citing Miller v. Johnson*, 15 US 900, 923 (1995)).

Second, provisions of the statute itself—and their implementation—demonstrate conclusively that Congress did not have the necessary evidence of a compelling interest at the time it passed TEA-21. In fact, Congress still has no such evidence. For the first time in any statute anywhere, Congress in TEA-21 ordered GAO to collect very specific information about DBE participation in DOT highway contracting, including the participation rate of DBEs in DOT prime and subcontracts. Pub. L. 105-178,

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The panel's effort fails, however, because an ordinary hearing will include testimony on both sides of an issue and often heated debate about whom Congress should believe. Thus, only a committee's conclusions, detailed in its report, can assist validly in this inquiry.

§ 1101(b)(6); 112 Stat. 107, 114-15 (1998). Precisely these data were necessary to establish a compelling interest for TEA-21's DBE provisions before enactment. Since the data were not yet gathered, there can have been no compelling interest in 1998. GAO published its conclusions in June 2001, and, by concluding that there is insufficient information to assess the DBE program, proved that the necessary data still do not exist: "it is impossible to define the universe of DBEs, compare them with the transportation contracting community as a whole or gain a clear understanding of the overall impact of the DBE program." App. 58. GAO found the disparity studies it reviewed contained "significant weaknesses" that "create uncertainties about the studies findings." App. 8. Further, "the majority of states and transit authorities . . . had not conducted any type of analysis to identify" non-discriminatory reasons for any detected disparities. *Id.* Finally, GAO concluded that DOT "does not systematically track information on complaints of discrimination," and therefore "could not provide information on the total number of such complaints, the total number of investigations launched, or the outcomes of the investigations." *Id.* Without all of this information, there could be no strong basis in evidence of a compelling interest even if *post hoc* rationalizations could suffice.[25]

Third, floor statements indicate impermissible motive.[26] In fact, some legislators declared that TEA-21

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[25] GAO also found that "federal courts . . . have concluded that the federal DBE program serves a compelling governmental interest," but GAO relied for that assertion on the very decision this Court is reviewing. Further, GAO relied on the same false citation in Appendix A to the UI study that the panel quoted. *Infra*, n.17; App. 40. Such bootstrapping is self-evidently impermissible.

[26] This Court has expressly noted that floor statements are of scant value in equal protection analysis. As this Court stated unequivocally in *Kimel*, for example, "isolated sentences clipped from floor debates and legislative reports" that litigants

would never pass constitutional muster. Senator Sessions, for example, said that the DBE provision in TEA-21 "is not a remedy for specific governmental racial discrimination[;] . . . there has been no determination in this case the federal highway administration is systematically and pervasively biased in its operation." S1400. Even some DBE proponents admitted that TEA-21 would not be constitutional as passed, and relied expressly on regulations not yet written to rectify the problem.[27] Some legislators only made irrelevant observations that such programs do, in fact, increase DBE participation.[28] Other statements reveal that to the extent Congress was not engaged in mere logrolling[29] or ill-conceived efforts at economic development,[30] Congress was playing racial politics,[31] trying to engender "diversity,"[32] or attempting to remedy

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"cobbled together from a decade's worth of congressional reports and floor debates" is wholly insufficient to support their theory of Congressional intent—even under the rational basis test. 120 S.Ct. at 649.

[27] Senators Chaffee, Kerry, Baucus, and Boxer all pointed out that new regulations—not yet written—would narrowly tailor the program, S1412, 1409, 1423, 1433, but such regulations obviously could not retroactively generate a compelling state interest.

[28] *Infra*, n.13 (comments of Reps. Tausher and Poshard and Senators Warner and Kennedy).

[29] To whatever extent they were not engaging in racial politics, the chairmen of the House and Senate transportation committees exemplified the logrolling motive for the DBE program. *Infra*, n.13 (comments of Rep. Schuster and Senator Chaffee).

[30] Reps. Velasquez and Lampson referred to the DBE provisions of TEA-21 as a mere economic development program. H2010. Others recited the numbers of dollars spent and people employed by it. *Id.*; H2006.

[31] *Infra*, n.13 (comments of Reps. Norton and Bonior).

[32] Representative Jackson-Lee explained that DBE programs are a "necessary" attempt "to achieve true multi-

amorphous societal discrimination[33]—all forbidden motives under *Croson*. 488 US at 496; *Hopwood v. State of Texas*, 78 F.3d 932, 945 (5th Cir. 1996) ("there has been no indication from the Supreme Court, other than Justice Powell's lonely opinion in *Bakke*, that the state's interest in diversity constitutes a compelling justification for governmental race-based discrimination[; s]ubsequent Supreme Court caselaw strongly suggests, in fact, that it is not"). Notably absent, moreover, are references by Committees and individual legislators to Appendix A, on which the panel so heavily relied.

III. The Panel Misapplied The Narrow Tailoring Test By Finding That A Mandatory Presumption Is Not Overinclusive, That Race-Based Highway Contracting Was A Last Resort Solution For Difficulties In Capital Access, And That This Still-Expanding, Decades-Old Program Is Of Appropriately Limited Duration.

To survive summary judgment Respondents must demonstrate not only that Congress had a strong basis in evidence of a compelling interest, but also a strong basis in evidence that DOT's direct procurement DBE program is narrowly tailored. *City of Philadelphia*, 91 F.3d at 596. Further, there must be strong evidence of narrow tailoring in all four steps of the program's implementation: the

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cultural and multi-gender diversity amongst those people this government chooses to do business with." Cong. Rec. H2006 (daily ed. April 1, 1998).

[33] Senator Mosely-Braun flatly stated: "[T]he DBE Program is no more and no less than a structural response to a structural distortion of our society that is caused by 200 years of slavery and segregation. . . . It responds to the unfortunate but obvious fact that our society was constructed on the traditional station of women and minorities." S1420. (She did not explain, however, how by this logic Hispanics and Asians would be entitled to the presumption.)

definition of disadvantage, the certification process, the goal setting process, and the goal achievement machinery.[34] These four steps are a dependent sequence, moreover, so it is logically impossible to narrowly tailor the methods of achieving DBE goals unless each of the prior three steps is narrowly tailored, too. The panel misapplied this test; Respondents cannot meet this burden.

First, whereas this Court demands individualized inquiry, TEA-21 affirmatively precludes individualized inquiry. Second, whereas this Court permits highly focused, statutory racial classifications only as a last resort, all available evidence shows Congress and DOT ignored several race-neutral or more focused solutions. Third, this Court permits statutory racial classifications only for as long as the discrimination they are supposed to remedy persists. If Appendix A is sufficiently strong evidence of appropriately limited duration, however, then an end to alleged discrimination in construction still would not terminate the program.

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[34] The panel repeatedly asserted that the DBE program uses "aspirational goals," not quotas, as though the distinction contributes to narrow tailoring. *E.g.*, Pet. App. 65. Current equal protection law rejects the goal/quota distinction, however. *City of Jackson*, 199 F.3d at 215 ("it is irrelevant whether the [challenged racial preference] establishes 'goals' or 'quotas' for DBE participation . . . because '[a]ny one of these techniques induces employers to hire with an eye toward meeting numerical goals[; a]s such, they can and surely will result in individuals being granted a preference because of race"); *Lutheran Church-Missouri Synod v. F.C.C.*, 141 F.3d 344, 352-54 (D.C. Cir. 1998) ("we do not think it matters whether a government hiring program imposes hard quotas, soft quotas, or goals"); *Monterey Mechanical Co. v. Wilson*, 138 F.3d 1270, 1271 (9th Cir. 1998) ("the relevant question is not whether a statute requires the use of such measures, but whether it authorizes or encourages them.").

A. DOT Failed To Submit The Requisite Strong Evidence That TEA-21 Even Permits Individualized Inquiry Into Disadvantage, Let Alone Whether The Regulations Actually Provide For It.

This Court established conclusively in *Croson* that narrow tailoring requires "inquiry into whether or not the *particular* [D]BE seeking a racial preference has suffered from the effects of past discrimination" in which government somehow participated. *Croson*, 488 US at 508 (emphasis added). Thus, "a broad program that sweeps in all minorities with a remedy that is in no way related to past harms cannot survive constitutional scrutiny." *Hopwood*, 78 F.3d at 951. In this case, the challenged statute cannot be narrowly tailored because the statute affirmatively prohibits individualized inquiry and cannot be rescued by regulation. Furthermore, even if it were possible to narrowly tailor the mandatory presumptions by imposing contrary regulatory requirements for individualized inquiry, in this case DOT has not done so.

1. TEA-21 On Its Face Precludes The Requisite Strong Evidence Of Individualized Inquiry By Mandating That Disadvantage Be Presumed Instead Of Proven.

The DBE provision of TEA-21 is unconstitutional on its face because it precludes individualized inquiry. TEA-21 clearly requires DOT to "presume" all men of certain races and all women are "disadvantaged." 15 USC § 637(d)(3)(C); *See* Pet. App. 206. "A presumption is an assumption of fact resulting from a rule of law which *requires* such fact to be assumed from another fact or group of facts found or otherwise established. . . . " Uniform Rules of Evidence, Rule 13, *quoted in* 9 *Wigmore on Evidence* § 2493f (5th Ed. 1999) (citing A.L.I. Model Code of Evidence Rule 701(1,2)) (emphasis added). Thus, "if a basic fact ([race]) is established, the fact-finder *must*

accept that the presumed fact ([social and economic disadvantage]) has also been established, unless the presumption is rebutted." 1 *Weinstein's Federal Evidence* § 301.02[1] (2nd Ed. 2000) (emphasis added); *accord, Wigmore* § 2491; 2 *McCormick on Evidence* § 346 (5th Ed. 1999). Accordingly, one cannot simultaneously maintain a presumption while demanding actual evidence of the presumed fact. The presumption of delivery of properly posted mail, for example, affirmatively precludes any demand that the mailing party produce evidence that a letter actually reached its addressee unless and until some other party shows evidence that the letter did not arrive. *See McCormick*, § 343 at 439. Consequently, the mandatory presumption in TEA-21 affirmatively precludes any requirement for evidence of disadvantage. Such evidence of disadvantage would be necessary for truly individualized inquiry, and thus for sufficiently narrow tailoring. Moreover, whereas a statute that fails to require the necessary individualized inquiry may be unconstitutional "as applied," a statute that prohibits such inquiry is unconstitutional "on its face" because "the statute could never be applied in a valid manner." *Members of City Council of City of Los Angeles v. Taxpayers for Vincent*, 466 US 789, 797-98 (1984). TEA-21's DBE provisions are facially unconstitutional as a result.

DOT attempts to fix this problem by regulation. It labors in vain, however, because no regulation can so materially contravene a clear statutory directive. DOT attempts to provide for individualized inquiry by requiring "signed, notarized" statements and certifications of disadvantage from each applicant. 49 CFR § 26.67(a). This is surely a requirement for evidence. Fed. R. Civ. Pro. 56(e). "Regulations," however, "in order to be valid, must be consistent with the statute under which they are promulgated." *United States v. Larionoff*, 431 US 864, 873 (1977). A requirement for evidence of disadvantage is inconsistent with a requirement that disadvantage be presumed once race or sex is established. Consequently,

DOT's regulatory attempt to provide individualized inquiry in spite of the statutory presumption is void.

2. Even If Regulations Could Provide For Individualized Inquiry Despite The Presumption, DOT's Regulations Do Not: There Is No Real Inquiry, And The Determination Of Identity And Membership Of Racial Groups Entitled To The Presumption Is Irreparably Arbitrary.

In addition to the observation that the regulations are void, DOT's regulatory attempt to provide narrow tailoring fails for at least three reasons. First, as a practical matter, requiring someone to affirm the truth of an otherwise unsupported conclusion is hardly the same as engaging in an actual inquiry. An actual inquiry might include, for example, questions about whether the individual has a college degree, is a recent immigrant, has ever before attempted to go into business of any kind in America, or has ever experienced racism that hindered any such attempt. An actual inquiry might also include a requirement to describe any such experience. The regulations do not allow such questions. By its own terms, in fact, 49 CFR Part 26 distinguishes between the "individual determinations of social and economic disadvantage" required for members of some races, and "the presumption" granted to members of other races. 49 CFR § 26.67(d) (Oct. 1, 2000). Obviously, for those granted the presumption no individual determination is required.

Second, even if the requirement for sworn statements of disadvantage could constitute a sufficiently individualized inquiry, the DBE program is overinclusive because of "[t]he random inclusion of racial groups that, as a practical matter, may never have suffered from discrimination in the construction industry." *Croson*, 488 US at 506. The random nature of the inclusions is self-evident. Persons from 42 countries enjoy the presumption despite that members of Congress never uttered those countries'

names and despite that rates of successful business formation among persons from some of those groups are at or above the national average. *Concrete Works*, 86 F.Supp.2d at 1070 ("The leading group forming businesses in recent years . . . has been Korean Americans with formation rates almost twice as high as Chinese Americans who were exactly at the national average"). The presumption also includes every single lawfully admitted permanent American resident who happens to be female. 48 CFR § 26.5. Altogether, DOT presumes approximately 65% of the American population is socially disadvantaged, despite that there is not a scintilla of evidence, even in Appendix A, to suggest that Tuvaluvans, for example, have suffered discrimination in the American construction industry. Nor can there be any rational explanation for assuming that persons born on the west bank of the Fly River are socially disadvantaged while those born a few feet away on the opposite bank are not. *See Drabik*, 50 F.Supp.2d 741, 770 (S.D. Ohio 1999), *aff'd*, 214 F.3d 730 ("few things [could be] more repugnant to our constitutional system than . . . the sole criteria for exclusion being the side of a river . . . their ancestors decided to settle"). Nevertheless, as it stands, an Indonesian subcontractor will enjoy the presumption a while Papua New Guinean will have to submit preponderant proof. 49 CFR § 26.5.

Third, even if listing such a random assortment of groups could be narrowly tailored, the provisions for determining membership in such groups are irreparably overbroad. The latest proposed regulations provide that an individual must merely swear or affirm that he is a member of such a group (or that she is female). 66 Fed. Reg. 23208, 23213 (May 8, 2001). Though the certifying official can request further proof if there is "well founded reason" to question the applicant's group membership, there is no indication whatsoever as to what might constitute a "well founded reason." Further, the "proof" the official could request is severely restricted, such that "if a birth certificate is adequate for one group, then only a

single piece of evidence may be required from members of other groups." *Id.* at 23212. That single piece might be "a drivers license or a birth certificate," moreover, but all such evidence would prove is that the applicant (or his parents) has held himself out as a member of some presumptively disadvantaged group at least once before. This weakness in the process is irreparable because there is no workable definition of race. *Concrete Works*, 86 F.Supp.2d at 1069 ("there is no agreed working definition of Hispanic persons since they may be of different races and may have very different cultural, religious and geographic origins"); *infra*, n.12. Since race cannot be defined or associated with any given individual with sufficient precision, the program can never be narrowly tailored.

B. DOT Failed To Submit The Requisite Strong Evidence That Congress Tried Even The Obvious Race Neutral Options Before Enacting TEA-21.

Statutory racial classifications are permissible only in an "extreme case," 488 US at 509, and only when "every constitutional 'i' is dotted and every 't' is crossed," *Engineering Contractors*, 943 F.Supp. 1546, 1556 (S.D. Fla. 1996), *aff'd*, 122 F.3d 895 (11th Cir. 1997). In other words, a "race conscious remedy will not be narrowly tailored until less sweeping alternatives—particularly race-neutral ones—have been considered *and tried*." *Walker*, 169 F.3d at 985 (emphasis added); *accord, Williams v. Babbitt*, 115 F.3d 657, 666 (9th Cir. 1997). Like race-conscious remedies, moreover, race-neutral alternatives must be aimed at correcting the effects of deliberate discrimination. A race-neutral measure taken for the sole purpose of achieving some hazy notion of how much participation is "proper" for a given group in a particular line of work is nothing more than "discrimination for its own sake." *Regents of Univ. of Cal. v. Bakke*, 438 US 265, 307 (1978). Accordingly, as this Court held in *Croson*, since the seven barriers the panel identified are race-neutral, Congress' solution to them

must be race-neutral, too, if at all possible. If Congress had "a whole array of race-neutral devices to increase the accessibility of [government] contracting opportunities to small entrepreneurs of all races," 488 US at 510, then Respondents must produce a strong basis in evidence that Congress actually tried such solutions before enacting TEA-21. For example, "[i]f [D]BEs disproportionately lack capital or cannot meet bonding requirements, a race-neutral program of [federal] financing for small firms would, *a fortiori*, lead to greater minority participation." 488 US at 507. Likewise, given the seven barriers the panel identified, Respondents must produce a strong basis in evidence that Congress tried "[s]implification of bidding procedures, relaxation of bonding requirements, and training and financial aid for disadvantaged entrepreneurs of all races" before enacting TEA-21. *Id.* at 509-10.

Respondents did not, and cannot, produce such evidence. On the contrary, Appendix A and DOT's own regulations both show that race-neutral solutions were available but not tried. Appendix A laments:

> [m]inorities and women are always left out in any kind of design or planning phase for these projects, and that is why when [they] first know about them * * * it is traditionally too late to get [their] forces and resources together to react.

61 Fed. Reg. at 26060 (*citing* H.R. Rep. No. 870, 103rd Cong., 2nd Sess. 13 (1994)). If so, then race-neutral requirements for open participation in the design stage of DOT projects must be attempted before racially discriminatory contracting practices. There is no evidence of such an attempt. Likewise, Appendix A notes that "[a]ll contractors on federal construction . . . contracts valued at over $100,000 are required to secure a surety bond guaranteeing the performance of the contract," and that minority firms' lack of experience precludes them from obtaining such bonds. *Id.* Therefore, Respondents must produce evidence that Congress tried waiving that bonding requirement for inexperienced firms before requiring

DOT to presume, *e.g.*, that every single Sri Lankan permanently residing in America has tried to enter the American highway construction business. Respondents produced no such evidence. Quite the opposite is true: DOT expressly acknowledged that a low bid system for subcontracting would be a race-neutral means of achieving DBE participation, 64 Fed. Reg. 5096, 5112, but nevertheless rejected this requirement for recipients of DOT financial assistance, *see* 49 CFR § 26.51.

C. Lacking Individualized Inquiry, There Can Be No Appropriate Limit To Duration, And Even If There Could Be, The Evidence In Appendix A Supports None; The DBE Program Is A Safe Harbor For Discrimination, Not A Remedy.

As this Court explained in this very case, Congress must ensure that a statutory racial classification has a finite duration "appropriately limited such that 'it will not last longer than the discriminatory effects it is designed to eliminate.' " 515 US at 237-238. DOT's direct procurement DBE program fails this test for at least three reasons.

First, because the program lacks individualized inquiry, it therefore also lacks limited duration. As Justice Powell wrote in *Wygant v. Jackson Board of Education*, "[i]n the absence of particularized findings, a court could uphold remedies that are ageless in their reach into the past, and timeless in their ability to affect the future." 476 US 267, 276 (1986); *Croson*, 488 US at 498; *Regents of Univ. of Cal. v. Bakke*, 438 US 265, 307 (1978). Since the alleged remedy of TEA-21 precludes such "particularized findings," *Wygant* teaches that it also has no time limit. Certainly, there are no time limits for group entitlements to the presumptions. Large groups (*e.g.*, Asians) cannot be removed. They are mandated by statute. Small groups (*e.g.*, Tuvaluvans) can be added, 49 CFR § 26.7 (2000); 13 CFR § 124.103(d), and group after group has been, *see*,

e.g., 54 Fed. Reg. 12054 (March 23, 1989), but the regulations have no provisions for removing small groups from the presumptions and no group has ever been removed.[35] The program has been growing inexorably since its passage in 1978 as a result.[36] Pub. L. No. 95-507.

Second, if the evidence the panel relied on were sufficient, then the program would remain justified forever. As the requisite strong basis in evidence of a compelling interest in enacting TEA-21, the panel invoked a list of seven "barriers" to minority participation in commerce. *Infra*, part II. In essence, those barriers were limited to two observations: the construction industry is dominated by non-minority family firms that minorities find difficult to inherit; and minority enterprises that wish to compete with these family firms find it difficult to do so because, having neither experience nor collateral, they find it difficult to obtain bonding and capital and to develop strong, enduring relationships with vendors and customers. These factors are precisely the same factors that this Court considered in *Croson* and for which this Court rejected a race-conscious solution. They are nothing but "a host of non-racial factors which would seem to face a member of any racial group attempting to establish a new business enterprise. . . . " 488 US at 498-499. The panel and this Court in *Croson* both enumerated several such race-neutral factors, including "deficiencies in working capital, inability to meet bonding requirements, unfamiliarity with bidding procedures, and disability caused by an inadequate track record." *Id*. Whereas this Court enumerated these barriers to demonstrate lack of narrow

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[35] Except Laotians, but the removal was inadvertent and the group was reinstated. 54 Fed. Reg. 34717 (Aug. 21, 1989).

[36] The panel noted that DBE certifications expire after three years, Pet. App. at 62 *citing* 13 CFR § 124.1014, but this requirement does not contribute to narrow tailoring because a DBE can then simply apply for recertification. The social presumption never expires, and the economic presumption is an ineffective barrier to perpetual certification. *Infra*, n.4.

tailoring, however, the panel enumerated them in support of a compelling interest. As a result, if the panel was correct in finding a compelling interest on the basis of the seven barriers it recited, then it must have been in error in finding the DBE program narrowly tailored.[37]

Third, because the program allows aggregation of all minorities for purposes of meeting participation goals, it is not well calculated to root out and rectify discrimination and then end. On the contrary, it provides a safe harbor for discrimination. By providing no guidance whatsoever regarding what might constitute the "maximum practicable" use of DBE subcontractors, DOT regulations grant contracting officers great discretion in accepting or rejecting subcontracting plans. That discretion allows prime contractors to propose and meet their DBE participation goals by employing the DBE(s) of their choice. As a result, even if a prime contractor were truly bigoted, he could propose very high DBE goals in order to win prime contracts, then by hiring only Asian- or Hispanic-owned subcontractors, meet those goals while simultaneously maintaining a practice of the most horrid race discrimination imaginable against Black-owned subcontractors. *See Assoc. for Fairness in Bus., Inc. v. State of New Jersey*, 82 F.Supp.2d 353, 362 (D.N.J. 2000) (allowing satisfaction of goals "in a way that would bestow a windfall of remedial benefits on one group while depriving another group of any such benefit" is "clearly not narrowly tailored"). Because DOT's DBE program provides this safe harbor, it cannot possibly be described as narrowly tailored to smoke out and remedy discrimination. *See Croson*, 488 US at 721.

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[37] In addition, though the panel pointed out that TEA-21 itself will eventually expire, Pet. App. at 62-63, this fact cannot contribute to narrow tailoring if the panel's *post hoc* identification of the seven barriers is all that is required for a compelling interest in reenactment of the DBE program. Moreover, section 8(a), from which the presumptions are derived, is a permanent fixture of law.

CONCLUSION

Because Respondents have failed to produce the requisite strong basis in evidence to justify DOT's racially discriminatory practices, this Court must reverse the panel's judgment and remand with instructions to enter summary judgment for Adarand. *See, e.g., City of Jackson*, 199 F.3d 206 (summary judgment for plaintiff challenging racial preference program when government failed to meet burden of production of strong basis in evidence); *City of Philadelphia*, 91 F.3d 586 (same); *H.K. Porter Co., Inc. v. Metropolitan Dade County*, 975 F.2d 762 (11th Cir. 1992) (same); *J. Edinger and Son, Inc. v. City of Louisville*, 802 F.2d 213 (6th Cir. 1986) (same); *Kornhass Constr., Inc. v. Oklahoma*, 2001 WL 434387 (W.D. Okla. Feb. 9, 2001) (same); *Phillips and Jordan v. Watts*, 13 F.Supp.2d 1308 (N.D. Fla. 1998) (same); *Buddie*, 31 F.Supp. 571 (same); *Arrow Office Supply Co. v. City of Detroit*, 826 F.Supp. 1072 (E.D. Mich. 1993) (same).

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APPENDIX

United States General Accounting Office

Report to Congressional Committees

June 2001

DISADVANTAGED BUSINESS ENTERPRISES

Critical Information Is Needed to Understand Program Impact

[SEAL]

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Abbreviations

DBE	Disadvantaged Business Enterprise
DOCR	Department of Transportation's Office of Civil Rights
DOJ	Department of Justice
FHWA	Federal Highway Administration
FTA	Federal Transit Administration
GAO	General Accounting Office
MBE/WBE	Minority Business Enterprise/Women Business Enterprise
SBA	Small Business Administration
TEA-21	Transportation Equity Act for the 21st Century
UCP	Unified Certification Program
USDOT	Department of Transportation

June 1, 2001

Congressional Committees

The U.S. Department of Transportation's (USDOT) Disadvantaged Business Enterprise (DBE) program is designed to remedy the effects of current and past discrimination against small businesses owned and controlled by

socially and economically disadvantaged individuals and to foster equal opportunity in transportation contracting. The Surface Transportation Assistance Act of 1982 contained the first statutory DBE provision for federal highway and transit programs, requiring that at least 10 percent of the funds provided be expended with DBEs, unless the Secretary of Transportation determined otherwise. From 1983 through 1999, about $35 billion of the federal funds expended through USDOT-assisted highway and transit contracts went to DBEs. Congressional debate preceding the passage in 1998 of the Transportation Equity Act for the 21st Century (TEA-21), which reauthorized the DBE program, focused largely on the need for and impact of the DBE program. USDOT issued new regulations in 1999 that significantly altered the DBE program. These regulations were designed to respond to issues raised in the congressional debate and the Supreme Court's 1995 decision in *Adarand Constructors, Inc. v. Pena.*

In addition to reauthorizing the DBE program, TEA-21 required that we review the program's impact throughout the United States and directed us to include analyses of specific program-related issues in our review.[1] (See app. I for the section of TEA-21 requiring our study.) Accordingly, this report provides information on (1) important

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[1] Under TEA-21, at least 10 percent of the highway, transit, and research funds authorized by the act are to be expended with DBEs, unless the Secretary of Transportation determines otherwise. This report focuses on the DBE program applicable to state departments of transportation and transit authorities with respect to USDOT-assisted highway and transit contracts rather than on direct expenditures of federal funds by USDOT.

changes made to the DBE program since 1999, (2) characteristics of DBEs and non-DBEs that receive USDOT-assisted highway and transit contracts, (3) evidence of discrimination and other factors that may limit DBEs' ability to compete for USDOT-assisted contracts, and (4) the impact of the DBE program on costs, competition, and job creation and the impact of discontinuing the federal and nonfederal DBE programs.

To address these issues, we conducted a nationwide mail survey in October 2000 of the 52 state departments of transportation (including those of the District of Columbia and Puerto Rico) and the 36 largest transit authorities.[2] We received responses to our survey from all 52 state departments of transportation (states) and 31 transit authorities, for an overall response rate of 94 percent. Our survey instrument and overall results are included in appendix II and selected survey results are available at www.gao.gov/special.pubs/dbe. We also assessed USDOT's DBE program data, reviewed court cases addressing the constitutionality of USDOT's DBE program since 1995, and analyzed transportation-specific

[2] Transit authorities provide local or regional multiple-occupancy-vehicle passenger services for general public use. We planned to survey all transit authorities required to submit DBE program plans. However, the Federal Transit Administration (FTA) could not provide an accurate list of these transit authorities. Therefore, we surveyed the 36 largest transit authorities (as defined by the number of unlinked passenger trips in 1999) across the nation. These transit authorities accounted for two-thirds of the federal transit grant funds obligated in 1999.

disparity studies.[3] This report is not a compliance review and therefore does not address whether states and transit authorities followed the DBE program regulations or how USDOT enforced those regulations, particularly with respect to the certification of DBEs. (See app. III for a more detailed discussion of our report's scope and methodology.)

Results in Brief

The DBE program has changed significantly since USDOT issued new regulations in 1999, in part, to respond to a 1995 Supreme Court decision that heightened standards for federal programs that use race or ethnicity as a criterion in decision-making. The new regulations overhauled the DBE goal-setting process. States and transit authorities are no longer required to justify goals lower than 10 percent – the amount identified in the statutory DBE provision. Rather, goals are to be based on the number of "ready, willing, and able" DBEs in local markets. In addition, states and transit authorities must now use race-neutral measures (i.e., measures intended to help all small businesses, not just DBEs), such as outreach and technical assistance, to the greatest extent possible to

[3] These disparity studies measure the availability and utilization of minority- and women-owned businesses in transportation contracts. We chose to review only transportation-specific disparity studies published between 1996 and 2000, in part, because the DBE regulations state that any disparity study used in the DBE goal-setting process should be as recent as possible and focused on the transportation contracting industry.

achieve their DBE goals. Furthermore, the new regulations revised the eligibility requirements to include a personal net worth cap of $750,000 for the individuals who own and control DBEs. States and transit authorities were required to submit to USDOT new DBE program plans that reflected the new regulations in August 1999. About three-fourths of the states and transit authorities responding to our survey reported that the new regulations have made it more difficult for them to administer the DBE program. Furthermore, over half of the states and transit authorities indicated that the new regulations made it more difficult for DBEs to apply to the program. These views are probably attributable to the new goal-setting process that states and transit authorities must complete and the additional paperwork that DBEs must submit.

A lack of key information prevents anyone from gaining a clear understanding of the firms that participate in the DBE program and how these firms compare with the rest of the transportation contracting community. For example, we cannot calculate the total number of certified DBEs nationwide because of duplication in states' and transit authorities' DBE directories. In addition, about two-thirds of our survey respondents could not provide information on the annual gross receipts of DBEs or the personal net worth of the individuals who own and control DBEs – information that is required to determine eligibility for the program but is not reported to USDOT. The primary reason states and transit authorities cited for not being able to provide this information was that the

information was not in an electronic database and therefore would be too difficult and time-consuming to compile. Moreover, states and transit authorities are just starting to collect personal net worth information as required by the new regulations. In addition, about 95 percent of the states and transit authorities we surveyed could not provide information on the annual gross receipts of non-DBEs, and none could provide information on the personal net worth of the individuals who own and control non-DBEs. Although financial information on DBEs and non-DBEs is lacking, the majority of the states and transit authorities could provide basic information on DBEs, such as the total number of prime contracts awarded to the firms – information that is regularly reported to USDOT. These data indicate that DBEs received about 7 percent of the prime contracts awarded and 2 percent of the federal dollars awarded for prime contracts in fiscal year 2000.

A variety of sources could provide information relevant to whether discrimination limits the ability of DBEs to compete for USDOT-assisted contracts. These sources include relevant court cases; studies of lending, bonding, and business practices affecting the formation and competition of such firms; state and local disparity studies; and discrimination complaints. Our review focused on court cases addressing the constitutionality of the federal DBE program; transportation-specific disparity studies; and written complaints of discrimination filed by DBEs with states, transit authorities, and USDOT. We focused on these sources because they are directly related to transportation contracting and the federal DBE program. In summary, we found the following:

- The federal courts that have considered the constitutionality of USDOT's DBE program under the standard adopted by the Supreme Court in 1995 have concluded that discrimination adversely affects DBEs. These decisions were based on various types of evidence, including studies of business practices affecting DBE formation and competition, and disparity studies. In these cases, the courts found that the evidence of discrimination presented was sufficient for them to conclude that the federal DBE program serves a compelling governmental interest, namely, providing a remedy for that discrimination.

- Studies finding statistical disparities between the availability and utilization of minority- and women-owned firms in transportation contracting are recognized as a potential source of evidence of discrimination. As a result, numerous state and local governments have conducted disparity studies to support their minority contracting programs and to help set their federal DBE participation goals. All 14 studies we reviewed found that there were disparities between the availability and utilization of minority- and women-owned businesses in transportation contracts. Taken as a whole, these studies suggest that disparities exist; however, we found significant weaknesses in the disparity studies we reviewed. For example, the studies consistently overstated the number of qualified, willing, and able firms or understated firms' utilization in transportation contracts. The weaknesses we identified create uncertainties about the studies' findings – that is, they could result in either an overstatement or an understatement of minority- and women-owned businesses availability and utilization.

- USDOT does not systematically track information on complaints of discrimination filed with the Department by DBEs – information that could shed light on the existence of discrimination against DBEs. For example, although USDOT receives written discrimination complaints filed by DBEs, it could not provide the total number of such complaints, the total number of investigations launched, or the outcomes of the investigations. We also asked states and transit authorities about written discrimination complaints filed by DBEs in 1999 and 2000. Eighty-one percent of the states and transit authorities reported that they did not receive any written complaints of discrimination filed by DBEs during this period. Nineteen percent of the states and transit authorities reported that they received a total of 31 written discrimination complaints from DBEs in 1999 and 2000. Of the 31 complaints filed, 29 had been investigated. Four of these investigations resulted in findings of discrimination.

Other factors may also limit the ability of DBEs to compete for USDOT-assisted contracts. According to our survey results, the majority of the states and transit authorities we surveyed had not conducted any type of analysis to identify these factors. Using anecdotal information, we identified a number of factors, or barriers, such as a lack of working capital and limited access to bonding, that may limit DBEs' ability to compete for

contracts. However, there was little agreement among the officials we contacted on whether these factors were attributable to discrimination.

Limited data prevent a thorough assessment of the impact of the DBE program, including the impact on DBEs of discontinuing the federal or nonfederal DBE programs. We identified one state and one transit authority that had discontinued their federal DBE programs as a result of court decisions. In addition, through our survey, we identified 10 other states and transit authorities that had participated in nonfederal DBE programs that had been discontinued. Ten of these 12 states and transit authorities could not provide sufficient data for us to fully evaluate the impact of this action. The data provided from the remaining two states indicate that discontinuing the federal and nonfederal programs had a negative impact on minority- and women-owned businesses.

Our report contains several recommendations to USDOT designed to (1) enhance the collection of data so that more and better information will be available to evaluate the impact of the DBE program and (2) help states and transit authorities set DBE participation goals that reflect the availability of ready, willing, and able DBEs in the relevant market. We recognize that implementing these recommendations may result in some additional costs for USDOT, states, and transit authorities. However, given existing data collection requirements and the benefits associated with these recommendations, we believe such costs are warranted. We provided USDOT with a draft of this report for review and comment. USDOT did not comment on our recommendations but offered comments

on such areas as the role of disparity studies in the DBE program, the need for states and transit authorities to use the best available data in DBE goal-setting, and the status of DBE and non-DBE participation data.

Background

USDOT established a minority and women's business enterprise program for its highway, airport, and transit programs by regulation in 1980. The Surface Transportation Assistance Act of 1982 contained the first statutory DBE provision for federal highway and transit programs, requiring that a minimum of 10 percent of the funds provided by the act be expended with small businesses owned and controlled by socially and economically disadvantaged individuals, unless the Secretary of Transportation determined otherwise. Nonminority women were not included as socially and economically disadvantaged individuals. The Surface Transportation and Uniform Relocation Assistance Act of 1987 continued the program and included nonminority women in the statutory definition of socially and economically disadvantaged individuals, thereby allowing states to use contracts with both minority- and women-owned businesses to meet their DBE goals. The Intermodal Surface Transportation Efficiency Act of 1991 and TEA-21 (1998) reauthorized the program, continuing the combined 10- percent provision for participation by minority-owned and nonminority-women-owned DBEs. The percentage of federal funds expended through USDOT-assisted highway and transit contracts with DBEs increased from 9.9 percent in 1983 to 12.8 percent in 1999.

TEA-21 and USDOT's regulations establish the basic eligibility requirements for participation in the DBE program. The program is limited to small businesses owned and controlled by socially and economically disadvantaged individuals. Women and members of certain minority populations, such as African-, Hispanic-, and Native-Americans and other minorities found to be disadvantaged by the Small Business Administration (SBA), are presumed to be socially and economically disadvantaged unless proved otherwise.[4] These individuals must own at least 51 percent of the firm and actually control its operations. To qualify as a small business, a firm must have average annual gross receipts over a 3-year period that do not exceed either (1) the applicable SBA small business size standards[5] or (2) a USDOT-specific cap ($17.4 million).[6] There is no legislative or administrative

[4] Firms owned and controlled by those who are not presumed to be socially and economically disadvantaged may qualify for the program if the owner can demonstrate disadvantage. However, no individual whose personal net worth exceeds $750,000 may be considered economically disadvantaged. This amount does not include the individual's interest in the business or equity in a primary residence.

[5] SBA's size standards define the maximum size at which a firm can be considered a small business. The size standards are usually defined by the number of employees or the average annual receipts.

[6] TEA-21 established a cap of $16.6 million, but authorized the Secretary of Transportation to adjust this amount for inflation. In August 2000, USDOT raised this cap from $16.6 million to $17.4 million. Since the change was effective only for the last 2 months of fiscal year 2000, we used the $16.6 million figure when we asked in our questionnaire for fiscal year 2000 data on annual gross receipts.

requirement limiting the length of time firms can participate in the program. However, DBEs become ineligible, or "graduate," when their average annual gross receipts over a 3-year period exceed the applicable SBA small business size standards or the USDOT-specific cap. According to our survey results, most of the states and transit authorities did not have any DBEs graduate in 2000. In addition, about one-quarter of the states and transit authorities we surveyed could not provide this information. States and transit authorities are not required to track this information, and graduation is not a goal of the DBE program. Moreover, as we reported in 1994,[7] because average annual gross receipts do not reliably indicate DBEs' success, graduation is not a useful measure of the success of the program as a whole.

USDOT administers the DBE program through the Office of the Secretary and the Department's operating administrations, including the Federal Transit Administration (FTA) and the Federal Highway Administration (FHWA). USDOT develops program policies, instructions, and procedures; reviews and approves states' and transit authorities' DBE program plans; and provides technical assistance, among other things. States and transit authorities must certify that program applicants meet the eligibility criteria, reassess annually the eligibility of certified businesses, and establish overall annual goals for the participation of DBEs in their USDOT-assisted contracts. DBE participation goals are expressed as a percentage of

[7] *Highway Contracting: Disadvantaged Business Program Meets Contract Goal, but Refinements Are Needed* (GAO/RCED-94-168, Aug. 17, 1994).

all federal highway and transit funds expended on USDOT-assisted contracts in a fiscal year.

One of the sources states and transit authorities may use to help set their overall federal DBE participation goals is data derived from disparity studies, which measure the availability of minority- and women-owned businesses compared with their utilization in contracting. States and transit authorities also use disparity studies to support state and local minority business contracting programs. The significance of disparity studies as evidence of discrimination in this context was discussed in a 1989 Supreme Court decision.[8] In *City of Richmond v. J.A. Croson Co.*,[9] the Court held that state and local programs that use race or ethnicity as a factor in apportioning public contracting opportunities are subject to strict scrutiny.[10] This means that the programs must serve a

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[8] This decision does not address state and local governments' implementation of the federal DBE program. Furthermore, several members of the Court stated that, unlike state and local governments, the Congress legislates on a nationwide basis and has inherently broader powers to remedy discrimination. Therefore, the Congress may deserve greater deference than state and local governments. Also, we note disparity studies are not required to support their participation in the federal program.

[9] 488 U.S. 469 (1989).

[10] The purpose of strict scrutiny is to ensure that the goal of the program is important enough to warrant treating people differently on the basis of their race or ethnicity and that the means chosen to achieve the goal fit it so closely that there is little or no possibility that an illegitimate prejudice or stereotype is the motive for such different treatment. Programs that use gender as a factor in decision-making are subject to a more lenient standard than those involving race or ethnicity.

compelling governmental interest and be narrowly tailored – that is, designed to be no broader than necessary – to meet that interest.

The Court found that combating racial discrimination is a compelling interest. However, it held that the city had not presented sufficient evidence of discrimination to justify its minority contracting plan. In evaluating the city's evidence, the Court found, among other things, that the city had inappropriately relied on the disparity between the number of prime contracts awarded to minority firms and the minority population of Richmond. It stated that an appropriate disparity evaluation would compare the percentage of qualified minority contractors with the percentage of dollars actually awarded to minority businesses.[11] While courts have favorably cited disparity studies in some cases,[12] many courts have rejected the studies' findings, often because of methodological weaknesses, when considering whether a compelling interest

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These programs must be substantially related to the achievement of an important governmental interest.

[11] Several members of the Court emphasized that an inference of discrimination could arise from a significant statistical disparity between the number of qualified, willing, and able minority contractors and the number actually engaged to perform a particular service.

[12] *See, e.g., Cone Corp. v. Hillsborough County*, 908 F.2d 908 (11th Cir. 1990), *cert. denied*, 498 U.S. 983 (1990) and *Concrete General, Inc. v. Washington Suburban Sanitary Comm'n*, 779 F. Supp. 370 (D. Md. 1991) (both finding that statistical analyses presented in connection with motions for summary judgment did not suffer from the defects identified by the Supreme Court in *Croson*).

exists for state or local minority contracting programs.[13] These decisions provide varying degrees of guidance on the data and methodology that need to be used in disparity studies to produce reliable evidence of discrimination.

A 1995 Supreme Court decision had a significant impact on the federal DBE program, as well as other federal programs that use race or ethnicity as factors in decision-making. *Adarand Constructors, Inc. v. Pena*[14] involved FHWA's use of a subcontracting compensation clause in direct federal contracting to implement the DBE

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[13] *See, e.g., W.H. Scott Construction Co., Inc. v. City of Jackson,* 199 F.3d 206 (5th Cir. 1999) (study did not include an analysis of the availability and utilization of qualified minority subcontractors, the relevant statistical pool for the city's program); *Engineering Contractors Ass'n of South Florida, Inc. v. Metropolitan Dade County,* 122 F.3d 895 (11th Cir. 1997), *cert. denied,* 523 U.S. 1004 (1998) (marketplace study included the number of licensed construction contractors rather than the number of firms willing, able, or qualified to perform work on county construction contracts and data on certain minority and women contractors did not contain any statistically significant unfavorable disparities after accounting for firm size); *Concrete Works of Colorado, Inc. v. City and County of Denver,* 86 F. Supp. 2d 1042 (D. Col. 2000) (studies assumed that all existing firms were available to perform within applicable time constraints and aggregated available minority firms regardless of their size or the services they performed); *Phillips & Jordan, Inc. v. Watts,* 13 F. Supp. 2d 1308 (N.D. Fla. 1998) (study assumed that every firm included in selected standard industrial codes was qualified, willing, and able to bid on road maintenance contracts and calculated availability and utilization rates on a statewide basis, even though contracts were let on the district level).

[14] 515 U.S. 200 (1995).

provision and provisions of the Small Business Act.[15] Adarand Constructors, a nondisadvantaged contractor, initiated the litigation in 1990 after it was denied a subcontract on a federal lands highway project. In 1992, the district court held that the programs at issue were constitutional, and in 1994 the Tenth Circuit Court of Appeals affirmed that decision.[16] In 1995, the Supreme Court set aside the Court of Appeals' decision and sent the case back to the lower courts, directing them to apply the strict scrutiny standard and thus determine whether the programs were narrowly tailored to further a compelling governmental interest. Applying this standard, the district court held that the subcontracting compensation clause and related statutory provisions were unconstitutional in 1997.[17] This decision was the subject of considerable discussion during the congressional debate over the

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[15] The subcontracting compensation clause provided prime contractors additional compensation for hiring subcontractors certified as small businesses controlled by socially and economically disadvantaged individuals.

[16] *Adarand Constructors, Inc. v. Pena,* 16 F.3d 1537 (10th Cir. 1994); *Adarand Constructors, Inc. v. Skinner,* 790 F. Supp. 240 (D. Colo. 1992).

[17] *Adarand Constructors, Inc. v. Pena,* 965 F. Supp. 1556 (D. Colo. 1997). On appeal, the Tenth Circuit Court of Appeals found that the case was moot since Adarand Constructors had been certified as a DBE after the district court's decision. *Adarand Constructors, Inc. v. Slater,* 169 F.3d 1292 (10th Cir. 1999). However, the Supreme Court held that the case was not moot and directed the Tenth Circuit Court of Appeals to consider the district court's 1997 decision. *Adarand Constructors, Inc. v. Slater,* 528 U.S. 216 (2000).

reauthorization of the DBE program as part of TEA-21, which was enacted in 1998.[18]

Responding largely to the Supreme Court's 1995 decision and congressional debate over the DBE program, USDOT issued regulations in 1999 to ensure that the DBE program is narrowly tailored. In addition, the regulations are designed to ensure nondiscrimination in the award and administration of USDOT-assisted contracts, remove barriers to the participation of DBEs in such contracts, and provide appropriate flexibility to the recipients of federal funds in establishing and providing opportunities to DBEs, among other things. In September 2000, the Tenth Circuit Court of Appeals upheld the constitutionality of the current DBE program because it found that the program served a compelling governmental interest and was narrowly tailored, largely because of structural changes in the program resulting from USDOT's new regulations.[19] Adarand Constructors requested that the Supreme Court review the Court of Appeals' decision in November 2000. In March 2001, the Supreme Court agreed to hear the case.[20]

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[18] USDOT believes that the Congress established a compelling governmental interest in the DBE program through the body of evidence that supporters of the program presented during the congressional debate over the program and the subsequent reauthorization of the DBE provision in TEA-21.

[19] *Adarand Constructors, Inc. v. Slater*, 228 F.3d 1147 (10th Cir. 2000). By the time of the Tenth Circuit Court of Appeals' decision, FHWA had discontinued its use of the subcontracting compensation clause.

[20] *Adarand Constructors, Inc. v. Mineta*, 121 S. Ct. 1401, *amended by* 69 U.S.L.W 3670 (U.S. Apr. 13, 2001) (No. 00-730).

USDOT's New Regulations Significantly Changed the DBE Program

USDOT's 1999 DBE regulations made significant changes to the DBE program. For example, the new regulations overhauled the program's goal-setting process, including the use of race-neutral measures (e.g., technical assistance) and revised its eligibility requirements. In addition, the new regulations required that states and transit authorities develop bidders lists and unified certification programs, among other things, to make the DBE program more streamlined and efficient. However, 72 percent of the states and transit authorities responding to our survey indicated that the new regulations have made it more difficult for them to administer the program. In addition, over half of the states and transit authorities indicated that the new regulations have made it more difficult for DBEs to apply to the program.

New Goal-Setting Process Shifts Focus of Program

The new goal-setting process shifted the focus of the program from achieving the maximum feasible extent of DBE participation in USDOT-assisted contracting to achieving a "level playing field" – that is, the amount of participation DBEs would be expected to achieve in the

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The Supreme Court will address the following two questions: (1) Did the court of appeals misapply the strict scrutiny standard in determining if Congress had a compelling interest to enact legislation designed to remedy the effects of racial discrimination? and (2) Is USDOT's current DBE program narrowly tailored to serve a compelling government interest?

absence of discrimination. For example, under the prior regulations, states and transit authorities were required to justify goals lower than 10 percent – the amount identified in the statutory DBE provision. The regulations established a direct link between the amount of participation identified in the statute and the goals set by states and transit authorities. In contrast, the new regulations require states and transit authorities to base their DBE participation goals on demonstrable evidence of the number of "ready, willing, and able" DBEs available in local markets relative to the number of all businesses "ready, willing, and able" to participate in USDOT-assisted contracts in such markets – representing the level of DBE participation expected in the absence of discrimination.[21]

The regulations outline a two-step process for goal-setting. First, states and transit authorities must establish a base figure that represents the "ready, willing, and able" DBEs in the state or transit authority's market relative to all "ready, willing, and able" firms in that market (i.e., relative availability of DBEs). To determine the relative availability of DBEs, the new regulations require that states and transit authorities use the best available data and suggest that states and transit authorities use DBE directories and Census Bureau data, bidders lists, disparity studies, or the goal of another recipient. Second,

[21] According to the new regulations, the 10-percent goal established in TEA-21 is an aspirational goal at the national level that USDOT will use as a means of evaluating the overall performance of the DBE program nationwide; however, it is not tied to individual states and transit authorities and does not require that states and transit authorities set a 10-percent goal.

states and transit authorities must adjust their base figure to account for other factors affecting DBEs, such as the capacity of DBEs to perform work in USDOT-assisted contracts and findings from disparity studies. According to our survey results, the most common sources used to set states' and transit authorities' fiscal year 2000 participation goals were DBE directories, historical utilization patterns, Census Bureau data, and bidders lists. Under the new goal-setting process, the average DBE participation goal decreased from 14.6 percent in fiscal year 1999 to 13.5 percent in fiscal year 2000.

The new regulations also require that states and transit authorities meet the maximum feasible portion of their overall DBE goals using race-neutral measures rather than race-conscious measures. The prior regulations did not require the use of race-neutral measures (e.g., outreach and technical assistance), which are designed to increase contracting opportunities for all small businesses, and do not involve setting specific goals for the use of DBEs on individual contracts. A race-conscious measure is one that is focused solely on assisting DBEs. An example of a race-conscious measure is a contract goal – that is, a DBE participation goal set for a specific contract or project. While quotas are prohibited and set-asides are allowed only in the most extreme cases of discrimination, states and transit authorities must use contract goals to meet any portion of their overall goals they do not expect to meet using race-neutral measures.[22]

[22] To the extent that race-conscious measures are no longer needed to achieve overall goals, states and transit authorities must discontinue their use.

States and transit authorities must submit their overall DBE participation goals, including the methodology used to set the goals and the projected use of race-neutral and race-conscious measures, to USDOT for approval on an annual basis. The states and transit authorities we surveyed indicated that, on average, they used race-neutral measures to achieve slightly over one-third of their overall DBE participation goals in fiscal year 2000.

New Eligibility Requirement Focuses on Owners' Personal Wealth

The new regulations established a personal net worth cap for individuals whose ownership and control of a business determines DBE eligibility. According to USDOT, this new eligibility requirement is designed to ensure that the program is limited to firms owned and controlled by genuinely disadvantaged individuals. Prior to the new regulations, the absence of a limit on personal net worth led to criticism that wealthy individuals could benefit from the program. Under the new regulations, to qualify as economically disadvantaged, individuals who own and control DBEs must have a personal net worth that does not exceed $750,000. USDOT chose the $750,000 cap because it is a well-established standard for the SBA's programs. According to our survey results, the number of firms that exceeded this limit and became ineligible for the DBE program in fiscal year 2000 ranged from 0 in 14 states and transit authorities to 39 in 1 state. Twenty-two percent of the states and transit authorities we surveyed reported that this information was not available.

New Regulations Include Other Requirements to Improve the DBE Program

The new regulations include other changes designed to improve the effectiveness and efficiency of the DBE program. For example, states and transit authorities are now required to create and maintain a bidders list, which is a record of all firms that bid on prime and subcontracts for USDOT-assisted projects. The list must include each firm's name, its status as a DBE or non-DBE, its years in operation, and its annual gross receipts.[23] The list is intended to count all firms that are participating, or attempting to participate in USDOT-assisted contracts; however the regulations do not specify how often the bidders list must be updated, for example, to ensure that firms no longer available are removed from the list. USDOT believes that the bidders list is a promising tool for states and transit authorities to accurately measure the relative availability of "ready, willing, and able" DBEs when setting their DBE goals. Sixty percent of the states and transit authorities we surveyed reported that they are in the process of developing or implementing their bidders lists while 27 percent indicated that their lists are fully implemented. Eight percent of the states and transit authorities reported that they had not yet started developing their bidders lists. The remaining 5 percent of the states and transit authorities reported that their bidders lists were in some other stage of development.

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[23] USDOT issued an interim final rule in November 2000, specifying that states and transit authorities could collect annual gross receipts information from firms in ranges rather than exact figures.

Another change designed to improve the efficiency of the DBE program is the requirement that states and transit authorities develop and participate in a unified certification program (UCP). A UCP provides "one-stop shopping" for DBEs because it makes all DBE certification decisions within a state. All recipients within a state must honor the certification decisions of the UCP. Prior to the new regulations, DBEs often had to obtain separate certifications from multiple recipients within one state. For example, in California there were about 60 certifying agencies throughout the state. Under the new regulations, DBEs will have to be certified by only one agency to participate in the DBE programs administered by all recipients in that state. By March 2002, the state DOT and all transit authorities within each state must sign an agreement establishing the UCP for that state and submit an implementation plan to USDOT for approval. The UCP must be fully operational no later than 18 months after USDOT approves the plan. The majority of the states and transit authorities (72 percent) we surveyed indicated that their UCPs were in some stage of development or implementation while 7 percent indicated that their UCPs were fully implemented; 14 percent reported that they had not yet started to develop their UCPs; and the remaining 6 percent noted that their UCPs were in some other stage of development.[24]

[24] Percentages do not add to 100 percent because of rounding.

New Regulations Make Application to and Administration of the DBE Program More Difficult

Fifty-four percent of the states and transit authorities we surveyed indicated that the new regulations had made it somewhat or much more difficult for DBEs to apply to the DBE program. This view could be attributable to the requirement for additional documentation that DBEs must now submit – specifically, documentation of the personal net worth of the individuals who own and control the firms. Furthermore, when states and transit authorities were asked to identify barriers to firms' participation in the DBE program, the two most common barriers cited were (1) reluctance to provide personal information and (2) the time required for certification paperwork. Despite these problems, most states and transit authorities (58 percent) indicated that they believe the benefits to firms participating in the DBE program outweigh any costs.

In addition, states and transit authorities reported that the new regulations made it more difficult to administer the program. For example, 59 of 82 states and transit authorities we surveyed reported that the new regulations had made it somewhat or much more difficult to administer the DBE program while 9 states and transit authorities indicated that the new regulations had made it easier to administer the program.[25] Fourteen states and transit authorities reported that there was no change orthey had no basis to judge. It is not surprising that most states and transit authorities reported that the new

[25] One survey respondent did not answer this question.

regulations made it more difficult to administer the DBE program, since the new regulations required that they completely overhaul their DBE goal-setting process and collect more information from DBEs and non-DBEs.

One source of frustration for states and transit authorities appears to be the process for developing and approving the new DBE program plans. The new regulations required that states and transit authorities develop and submit plans for fiscal year 2000 that reflected the requirements and changes under the new regulations to USDOT by August 31, 1999 – about 6 months after the effective date of the new regulations. During the approval process, USDOT sometimes sent the DBE plans back to states and transit authorities multiple times for revisions and clarifications.[26] One state noted that even after it had worked closely with USDOT's local office to develop its plan, USDOT headquarters twice rejected the plan. On average, it took USDOT 8 months to approve the 2000 DBE plans. According to our survey results, one state and seven transit authorities reported that their 2000 DBE plans had yet to be approved.

Limited Data Are Available on the Characteristics of DBEs and Non-DBEs

A lack of key information prevents anyone from gaining a clear understanding of firms that participate in the DBE program and how they compare with the rest of the

[26] According to USDOT, the plans were reviewed to ensure that they met legal requirements.

transportation contracting community. For example, we cannot use the information provided by the states and transit authorities we surveyed to calculate the total number of certified DBEs nationwide because of duplication in the states' and transit authorities' DBE directories. In addition, almost two-thirds of our survey respondents could not provide information on the annual gross receipts of DBEs or the personal net worth of the individuals who own and control DBEs – information that is used to determine firms' eligibility for the program but is not reported to USDOT and was not readily available. Furthermore, almost 95 percent of the states and transit authorities we surveyed could not provide information on the annual gross receipts of non-DBEs and none could provide information on the personal net worth of the individuals who own and control non-DBEs. While financial information on DBEs and non-DBEs is lacking, most states and transit authorities could provide some other type of information on DBEs, such as the total number of prime contracts awarded to DBEs – information that is regularly reported to USDOT. These data indicate, among other things, that DBEs received about 7 percent of the prime contracts awarded and 2 percent of the federal dollars awarded for prime contracts in fiscal year 2000.

Duplication and Data Problems Preclude Thorough Analysis of the DBE Community

We cannot calculate the total number of certified DBEs nationwide because of duplication in states' and transit authorities' DBE directories. States and transit authorities are required to maintain DBE directories that list all the

DBEs they have certified.[27] However, DBEs can be certified in multiple locations. For example, a DBE may be certified by Virginia, Maryland, Pennsylvania, and the District of Columbia. Unlike the SBA's Small and Disadvantaged Business program, which gives a unique identification number to each certified small and disadvantaged business, the DBE regulations do not require states and transit authorities to assign unique identifiers to certified DBEs. As a result, a DBE certified with four states would be listed in four different DBE directories. Because of this duplication, aggregating the number of certified DBEs listed in states' and transit authorities' DBE directories would significantly overstate the number of firms certified. While we cannot provide the total number of certified DBEs nationwide, our survey results indicate that the number of certified DBEs per state and transit authority varies greatly. For example, in fiscal year 2000, the number of certified DBEs per state or transit authority ranged from 39 in the state of Maine[28] to 3,350 in the Metropolitan Atlanta Rapid Transit Authority, with an average of 551 per state and transit authority.

Although FHWA could provide information on the demographics of DBEs that obtain highway contracts, FTA could not provide comparable data. As a result, the demographics of the entire DBE community are

[27] The DBE directories must be updated at least annually.

[28] The Metropolitan Transit Authority of Harris County (Houston, Texas) reported that it had no certified DBEs in 2000. According to USDOT, the Metropolitan Transit Authority has a DBE program, with a goal intended to be met with all race-neutral participation, but does not certify firms itself.

unknown. FHWA's data on DBE participation indicate that nonminority-women-owned businesses obtain a significant portion of contracts. Prior to 1987, states and transit authorities could not generally count contracts with nonminority-owned businesses toward DBE goals. The Surface Transportation and Uniform Relocation Assistance Act of 1987 included nonminority-women-owned businesses in the statutory definition of socially and economically disadvantaged individuals and thus allowed states and transit authorities to use contracts with both minority- and nonminority-women owned businesses to meet their DBE goals. According to FHWA's data, nonminority-women-owned businesses have become one of the most competitive groups in the DBE community since 1987. For example, in 1999 (the latest year for which these data are available), nonminority-women-owned businesses accounted for about 48 percent of all federal highway contract dollars awarded to DBEs; minority-owned businesses (those owned by both men and women) combined accounted for about 52 percent. (See fig. 1. [Figure 1 omitted in printing]) FTA was unable to provide reliable data on the demographics of the DBEs that were awarded federal transit contracts, even though transit authorities must provide this information to FTA on a quarterly basis.[29] According to FTA, it does not centrally compile this information.

[29] States and transit authorities must submit certain information about DBEs to USDOT on a quarterly basis, such as number of firms awarded prime and subcontracts, the ethnicity of the firms' owners, and the type of work the firms perform.

Data Are Available to Calculate Participation Rate of DBEs in Prime Contracts but Are Limited for Subcontracts

The majority of the states and transit authorities we surveyed (78 percent) provided sufficient data – that is, the number and value of prime contracts awarded to DBEs and non-DBEs – to determine DBEs' participation rates in prime contracts.[30] According to the data we obtained from these states and transit authorities, DBEs received about 7 percent of the prime contracts awarded and 2 percent of the federal dollars awarded for prime contracts in fiscal year 2000. In comparison, about 70 percent of the states and transit authorities could not provide both the number and value of subcontracts awarded to DBEs and non-DBEs – information necessary to calculate DBEs' participation rates in subcontracts. Because DBEs are small businesses and are more likely to compete for subcontracts, which generally require fewer resources (e.g., capital, equipment, and employees) than prime contracts, the lack of subcontracting data prevents anyone from gaining a complete understanding of DBEs' participation in transportation contracting. The data provided from about one-third of the states and transit authorities indicate that DBEs received about 33 percent of all subcontracts awarded and 26 percent of the federal dollars awarded through subcontracts in fiscal year 2000. However, because this information is based on a small number of states and transit authorities, it may not be

[30] We measured DBEs' participation rates in USDOT-assisted contracts using both the number and value of the prime and subcontracts awarded.

representative and therefore should not be generalized to the entire DBE community.

The participation rates of DBEs in both prime and subcontracts in fiscal year 2000 indicate that they received a relatively small percentage of federal prime and subcontracts and dollars when compared with non-DBEs. However, we do not know whether the percentage is disproportionately low. Such a determination cannot be made without an accurate measure of the availability of DBEs – that is, the number of DBEs "ready, willing, and able" to participate in prime and subcontracts compared with the number of non-DBEs.

Financial Profile of DBEs Cannot Be Determined With Current Data

The majority of states and transit authorities responding to our survey could not provide information on the annual gross receipts of DBEs. Specifically, 60 percent of these states and transit authorities could not provide information on the annual gross receipts of the DBEs that were awarded prime or subcontracts in fiscal year 2000. Furthermore, 75 percent of the states and transit authorities could not provide information on the annual gross receipts of the DBEs that were not awarded prime or subcontracts in fiscal year 2000. While the annual gross receipts of a DBE are required to determine the firm's eligibility for the program, this information is not reported to USDOT. The primary reason survey respondents cited for not being able to provide the information was that the information is not in an electronic database and therefore would be difficult and time-consuming to

compile. The information that was provided from a limited number of states and transit authorities indicates that most DBEs' annual gross receipts are below $5 million – well below the current USDOT-specific cap of $17.4 million. Furthermore, 85 percent of the DBEs awarded contracts in fiscal year 2000 had annual gross receipts of less than $5 million. In comparison, 94 percent of the DBEs that did not receive a contract in fiscal year 2000 had annual gross receipts of less than $5 million. However, because this information is based on only a small percentage of the states and transit authorities we surveyed, it may not be representative and therefore should not be generalized to the entire DBE community. (For more detailed information see app. II.)

The majority of the states and transit authorities we surveyed could not provide information on the personal net worth of the individuals who own and control DBEs. Specifically, about 65 percent of the states and transit authorities indicated that they could not provide information on the personal net worth of the owners of DBEs that were awarded prime contracts in fiscal year 2000. Sixty-seven percent of the states and transit authorities reported that they could not provide information on the personal net worth of the owners of DBEs that were awarded subcontracts in fiscal year 2000. In addition, 81 percent of the states and transit authorities indicated that they could not provide information on the personal net worth of the owners of DBEs that were not awarded prime contracts in fiscal year 2000. Seventy-eight percent of the states and transit authorities indicated that they could not provide information on the personal net worth

of the owners of DBEs that were not awarded subcontracts in fiscal year 2000. Similar to the information on a firm's annual gross receipts, personal net worth information is required to determine a firm's eligibility for the program but is not reported to USDOT. Since this eligibility requirement was introduced in the new regulations, states and transit authorities are just starting to collect this information.[31] Over 60 percent of the states and transit authorities indicated that they could not provide this information because it is not electronically maintained and therefore would be difficult and time-consuming to compile and report.

The information that was provided from a limited number of states and transit authorities indicates that over half of the DBEs that received prime and subcontracts in fiscal year 2000 had owners whose personal net worth was less than $250,000. Additionally, the data indicate that the personal net worth of the owners of DBEs receiving prime contracts was higher than the personal net worth of the owners of DBEs receiving subcontracts. However, because this information is based on the responses of a small percentage of all states and

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[31] According to the regulations, firms applying to the DBE program must provide a signed and notarized statement of personal net worth from the individuals whose net worth is used to determine the firms' DBE eligibility. Firms that were participating in the program before the effective date of the new regulations (Mar. 1999) would have to submit the information the next time they applied for recertification, which occurs every 3 years. Hence, information on personal net worth may not be collected from all DBEs until fiscal year 2002.

transit authorities, it may not be representative and therefore should not be generalized to the entire DBE community. (For more detailed information see app. II.)

Lack of Data Prevents a Financial Profile of Non-DBEs

Currently, the financial status of DBEs cannot be compared with that of the transportation contracting community as a whole because most states and transit authorities do not collect or maintain financial information on non-DBEs. For instance, over 90 percent of the states and transit authorities responding to our survey could not provide information on the annual gross receipts of non-DBEs. The primary reason for not being able to report the information was not having it in an electronic database. The new regulations require states and transit authorities to collect information on the annual gross receipts of the non-DBEs that bid on their USDOT-assisted contracts. This information is to be included in the states' and transit authorities' bidders lists. According to USDOT, states and transit authorities have expressed concern about their ability to collect this information because non-DBEs have been reluctant to share this information.

No survey respondent could provide information on the personal net worth of the owners of non-DBEs that were awarded prime or subcontracts in fiscal year 2000. The majority of the states and transit authorities (61 percent) indicated that they do not currently collect this information or plan to do so in the future. Only 8 percent reported that they plan to collect this information in the future. States and transit authorities are not required to

collect information on the personal net worth of the owners of non-DBEs.

Information on Discrimination and Other Barriers That May Limit DBEs

There are numerous sources that could contain information relevant to whether discrimination limits the ability of DBEs to compete for USDOT-assisted contracts, including studies of lending, bonding, and business practices affecting the formation and competition of minority firms; state and local disparity studies; discrimination complaints; and relevant court cases. We focused our review on court cases involving the federal DBE program since the Supreme Court's 1995 decision in *Adarand Constructors, Inc. v. Pena*, transportation-specific disparity studies published between 1996 and 2000; and written complaints of discrimination filed by DBEs with states, transit authorities, and USDOT. We focused on these sources because they are directly related to transportation contracting and the federal DBE program. However, we did not address whether the DBE program satisfies the requirements of strict scrutiny and is therefore constitutional. In our review, we found the following:

- The courts that have considered the constitutionality of the federal DBE program under the standard articulated in the Supreme Court's 1995 decision in the *Adarand* case have concluded that discrimination adversely affects DBEs.
- All 14 studies we reviewed found that there were disparities between the availability and utilization of minority- and women-owned

business enterprises (MBE/WBEs) in transportation contracts.[32] Taken as a whole, these studies suggest that disparities exist. However, none provide reliable evidence of disparity because the limited data used to calculate disparities, compounded by methodological weaknesses, create significant uncertainties about the studies' findings – that is, they could result in either an overstatement or an understatement of MBE/WBEs' availability and utilization.

- USDOT does not systematically track information on the discrimination complaints filed by DBEs – information that could shed light on the existence of discrimination against DBEs.

In addition, a number of factors are often cited by agency officials and representatives from both industry and minority associations as limiting DBEs' ability to compete for contracts. These factors include a lack of working capital and limited access to bonding. However, there was little agreement among the officials we contacted about whether these factors are attributable to discrimination or are barriers that all small businesses face.

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[32] Two studies did not have enough data to perform a statistically valid disparity ratio analysis of transportation-specific contracts, and instead conducted disparity analyses of contracts awarded by several agencies including the transportation agencies. Several studies analyzed disparity separately within sub-groups of MBE/WBEs. Disparity was found in at least one subgroup, but not in all of them.

Courts Have Found Sufficient Evidence of Discrimination to Justify the Federal DBE Program

In order to uphold a program, such as the federal DBE program, that uses race or ethnicity as a criterion for decision-making, a court must find sufficient evidence of discrimination to conclude that the program serves a compelling governmental interest. Therefore, cases considering the constitutionality of the federal DBE program can indicate whether discrimination adversely affects DBEs' participation in transportation contracting. The courts that have addressed the DBE program under the standard articulated by the Supreme Court's 1995 decision in *Adarand Constructors, Inc. v. Pena* (discussed on page 13 of this report) have found that the evidence of discrimination presented was sufficient for them to conclude that the program serves a compelling governmental interest, specifically, remedying the effects of discrimination against DBEs.[33]

Most recently, in its review of the DBE program in *Adarand*, the Tenth Circuit Court of Appeals concluded

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[33] Several additional challenges to the constitutionality of the DBE program are in various stages of litigation. In addition, in 1996, a district court in Texas concluded that the DBE program of the Metropolitan Transit Authority of Harris County was unconstitutional and called into question the constitutionality of the federal DBE program as well. See *Houston Contractors Ass'n v. Metropolitan Transit Authority of Harris County*, 993 F. Supp. 545 (S.D. Tex. 1997). The court did not, however, assess whether the programs served a compelling governmental interest. The Fifth Circuit Court of Appeals set aside the district court's decision and sent the case back to the district court for further review.

that discrimination adversely affects both the formation of qualified minority subcontracting businesses and their ability to successfully compete for highway construction subcontracts.[34] On the basis of the evidence presented,[35] the court found that discrimination by prime contractors, unions, and lenders impedes the formation of qualified minority businesses in the subcontracting market nationwide. The court also acknowledged the causal link between the availability of capital and the ability to implement public works construction projects and found

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[34] As discussed earlier, the Tenth Circuit Court of Appeals reversed a 1997 district court decision finding that the subcontracting compensation clause and DBE provision were unconstitutional. The district court had found that the programs at issue served a compelling interest, but were not narrowly tailored. The district court's findings regarding discrimination were adopted by another district court addressing a constitutional challenge to the DBE provision, the Department of Transportation's implementing regulations, and the state of Minnesota's federal DBE program. In that case, the district court found that the DBE program satisfied the first element of strict scrutiny on the basis of the district court's 1997 decision in *Adarand*. However, as in *Adarand*, the court concluded that the program was not narrowly tailored to serve the identified compelling interest. See *In re: Sherbrooke Sodding*, 17 F. Supp. 2d 1026 (D. Minn. 1998).

[35] Throughout its decision, the court referred to the congressional investigations, hearings, statistical and anecdotal evidence, and other studies cited in a 1996 Department of Justice review entitled "The Compelling Interest for Affirmative Action in Federal Procurement," 61 Fed. Reg. 26050 (1996). As a preliminary matter, the court found that the federal government need not be as geographically limited as states and local governments in remedying the effects of discrimination in markets created by the disbursement of federal funds.

that the studies cited by the government strongly supported a finding of discrimination in lending. For example, it cited a survey of 407 business owners in the Denver area that found significant differences in the loan denial rate for white, African-American, and Hispanic business owners, even after controlling for other factors like size and net worth.

The court also addressed barriers to competition by existing minority businesses. Citing congressional hearings and statistical evidence, among other things, the court found that minority businesses are often excluded by business networks of prime and subcontractors from opportunities to bid on construction projects. The court also discussed bonding requirements, finding another barrier to competition. For example, it cited a Louisiana study finding that minority firms were nearly twice as likely to be rejected for bonding; three times more likely to be rejected for bonding in amounts over $1 million; and, on average, charged higher rates for the same bonding policies than white firms with the same experience. Similarly, the court accepted evidence of suppliers' withholding price discounts from minority subcontractors, thus driving up their bids. In light of this evidence, the court rejected Adarand Constructors' argument that minority businesses face the same problems as all new businesses, regardless of the race of the owners.

Finally, the court considered disparity studies conducted by state and local governments.[36] In doing so, the court

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[36] Although states and local governments do not conduct disparity studies to justify the federal DBE program, the

accepted the government's finding, based on a review of disparity studies, that minority construction subcontracting firms received 87 cents for every dollar that they would be expected to receive given their availability. The court also acknowledged the potential for weaknesses in the data and methodology used in disparity studies and stated that particular evidence undermining the reliability of specific studies would be relevant to a determination regarding discrimination. However, it noted that Adarand Constructors had not provided it with evidence undermining the studies' reliability.[37] Furthermore, the court found that Adarand Constructors had failed to introduce credible, specific evidence to refute the government's showing of a compelling interest.[38] As a result, it held that there was sufficient evidence of discrimination

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Department of Justice review stated that disparity studies conducted by states and local governments throughout the country in connection with their own programs are of particular relevance to affirmative action measures in federal programs providing grants to such entities.

[37] The court acknowledged the need for studies to take into account the special qualifications needed to undertake the task at issue. However, the court stated that it was unaware of such qualifications, aside from the general qualifications necessary to operate a construction contracting business, and that the record was without evidence that the subcontractors who had been utilized had performed inadequately or otherwise demonstrated a lack of necessary qualifications.

[38] The court also "[took] notice" of evidence of the link between the discontinuance of a race-conscious program and minority business participation in the relevant market. The court stated that this evidence supported the claim of discriminatory barriers to participation by minority contractors.

to justify the use of racial and ethnic criteria in transportation contracting.

Data and Methodological Weaknesses Limit the Findings of Transportation-Specific Disparity Studies

Fourteen recent, transportation-specific disparity studies[39] concluded that disparities existed between the utilization of MBE/WBEs in transportation contracts and availability of these firms in the marketplace.[40]

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[39] We defined recent, transportation-specific disparity studies as studies published between 1996 and 2000 containing a separate disparity analysis on transportation contracting.

[40] We chose to review transportation-specific disparity studies published between 1996 and 2000, in part, because the new DBE regulations recommend that any disparity study relied on in the DBE goal-setting process should be as recent as possible and focused on the transportation contracting industry. We reviewed two additional transportation-specific studies published between 1996 and 2000 that examined minority- and women-owned business procurement. One of these studies did not use a traditional disparity ratio and thus is not included in our discussion. However, we did review the study and found that it contained methodological weaknesses that create uncertainties about its findings. The other study was considered a work in progress and thus was not included in our discussion. Both of these studies used new approaches to identify barriers to full and active MBE/WBE participation. For example, one study disaggregated the procurement process into discrete components to determine if any individual procurement practice negatively affects MBE/WBEs. USDOT has not conducted any disparity studies or any other type of analysis examining discrimination in federal transportation contracting because it believes such studies or analyses are not needed to justify the federal DBE program.

Numerous state and local governments have used disparity studies to support their minority contracting programs and in setting their federal DBE goals. For example, about 30 percent of the states and transit authorities we surveyed reported that they used a disparity study to help set their fiscal year 2000 DBE participation goals. However, our review of the 14 disparity studies found that the limited data used to calculate disparities, compounded by methodological weaknesses, create uncertainties about the studies' findings.[41] Rather than discuss the limitations of each study specifically, we have chosen to discuss some of the more common problems we found. While not all studies suffered from every problem, each suffered from enough problems to make its findings questionable. We recognize that there are difficulties inherent in conducting disparity studies and that such limitations are common to social science research; however, the disparity studies we reviewed did not sufficiently address such problems or disclose their limitations. It is not clear what conclusions a court would draw about the studies' findings.

The studies we reviewed relied on a disparity ratio – that is, a comparison of the availability of MBE/WBEs to their utilization in contracts – as an indicator of discrimination. However, the data necessary to properly calculate such

[41] Because our review of transportation-specific disparity studies was limited, our conclusions cannot be generalized to disparity studies as a whole. Moreover, the findings in any disparity study would be limited to the geographical scope of that particular study.

ratios – complete and accurate lists of MBE/WBEs' availability and utilization – are often lacking. An availability list should include all qualified, willing, and able firms in the relevant market area, grouped by industry subspecialties and by MBE/WBE or non-MBE/WBE status. A utiiization list should include all firms in the relevant market area that were awarded prime and subcontracts, grouped by industry subspecialty and MBE/WBE or non-MBE/WBE status. Because these data are often lacking, some proxies (i.e., substitute information) have been used to calculate disparity ratios.

To develop proxies of availability, the disparity studies we reviewed used sources including Census Bureau data, directories or other listings of firms, prequalification lists,[42] and/or bidders lists. These could be useful data sources. However, all of these data sources have shortcomings, whether used separately or in combination, that must be taken into account when using them as proxies for availability. Such shortcomings would result in availability lists that could either under- or overstate the number of firms available for transportation contracting. The limitations of using these data sources as proxies for availability include the following:

- Census Bureau data cannot adequately indicate whether a firm is truly available, that is, whether it has the qualifications, willingness, or ability to complete contracts. However, in using Census Bureau data, the studies

[42] A prequalification list, sometimes referred to as a precertification list, includes all firms that have been prequalified by states or transit authorities to compete for contracts.

depicted all operational firms as available for contracting. Some studies attempted to account for the qualifications of firms by including only firms in the relevant two-digit Standard Industry Classification (SIC) codes in their availability lists.[43] Using a finer degree of distinction (e.g., classification by the four-digit SIC code level) would help to ensure that firms are similar enough for comparison. For example, some studies used the two-digit SIC code for heavy construction, a category that includes firms as diverse as general contractors for highway construction and general contractors for radio tower construction.

- Directories and other listings do not contain information on firms' qualifications, willingness, or abilities. This could result in an overstatement of how many firms are available for transportation contracting. In addition, some of the data obtained from directories and listings were inaccurate. For example, some of the disparity studies we reviewed indicated that as many as 16 percent of the firms included in the directories and listings were unreachable because of such problems as disconnected telephones, wrong telephone numbers, incorrect addresses, or dissolution of the firms.

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[43] SIC codes are used to identify companies by their primary business activity. The activity is determined by the major product produced or service rendered. The coding system consists of major industries that are further divided into a multitude of minor groups identified by a four-digit SIC code.

- Prequalification and bidders lists may be better sources of availability than Census Bureau data or directories because they better approximate firms' qualifications, willingness, and ability to compete for contracts. However, the mechanisms used by states and transit authorities to compile them may limit their reliability. In the studies we reviewed, we found four problems. First, some studies we reviewed used bidders and prequalification lists that were updated infrequently or had no mechanism to ensure that firms no longer available were removed from the list. For example, one study used a list that never removed firms, increasing the risk that it contained firms no longer in business in the relevant market area. Second, some studies we reviewed used bidders or prequalification lists that were maintained for multiple city agencies, ranging from school districts to port authorities. Businesses qualified to perform school district work may not be qualified to perform port authority work. Third, the lists grouped all potential firms together, failing to take into account their industry subspecialty and capacity. Because of these problems, availability lists based on this information would overstate the number of firms that were qualified, willing, and able to perform transportation contracts. Finally, prequalification and bidders lists could under represent capable firms. Firms may refrain from participating because of perceived or actual barriers. For example, one study we reviewed surveyed firms and found that only 22 percent of those firms that expressed an interest in contracting with the

transit agency had actually attempted to obtain such work in the past.

The disparity studies we reviewed made few efforts to mitigate the problems with using these data sources as proxies for availability, nor did they disclose the limitations of their use. For example, the disparity studies did not sufficiently account for the lack of information on firms' qualifications when the availability lists were developed. One aspect of a firm's qualifications is its capability to handle transportation contracting. Some studies used average yearly revenue as a proxy for capability.

However, revenue does not adequately explain the differences in firms' capability. For example, two firms could have similar yearly revenues, but one firm might have performed 100 small contracts throughout the year because it did not have the capacity to perform large contracts, whereas the second firm might have performed two very large contracts. If revenue were used as a proxy for capability, these two firms would be considered equivalent.

In addition to determining the availability of firms, disparity studies must measure the utilization of MBE/WBEs to determine if disparities in contracting exist. This requires an analysis of both the number and dollar amount of contracts awarded to MBE/WBEs and non-MBE/WBEs. Such measurement is difficult because some states and transit authorities have incomplete records of the prime and subcontracts they have awarded. For example, several studies we reviewed did not include any analyses of subcontracting and therefore may understate

the utilization of firms. Because MBE/WBEs are more likely to be awarded subcontracts than prime contracts, MBE/WBEs in particular may appear underutilized when the focus remains on prime contractor data. Furthermore, although some studies did include calculations based on the number of contracts, all but two based their determination of disparities on only the dollar amounts of contracts. Because MBE/WBEs tend to be smaller than non-MBE/WBEs, they are often unable to perform larger contracts. Therefore, it would appear that they were awarded a disproportionately smaller amount of contract dollars. A more complete indicator of utilization would consider both the dollar amount and the number of contracts awarded or to control for differences in contract dollar amounts.

USDOT Has Not Provided Criteria for Reliability of Disparity Studies Used to Set DBE Goals

In March 2001, USDOT advised states and transit authorities that disparity studies used to set their DBE participation goals should be reliable. While pointing out that all or part of a disparity study pertaining to a local market area could provide a rich source of information for the goal-setting process, USDOT did not explain how states and transit authorities could evaluate the reliability of such studies. USDOT's guidance does not, for instance, caution against using studies that contain the types of data and methodological problems that we identified above. Without explicit guidance on what makes a disparity study reliable, states and transit authorities risk using studies that may not provide accurate information in setting their DBE goals.

Data on Written Discrimination Complaints Are Inconclusive

USDOT receives written complaints of discrimination from DBEs but does not systematically track or analyze information on these complaints.[44] As a result, this information is not readily available to shed light on the absence or presence of discrimination against DBEs. USDOT could not provide the total number of written complaints filed by DBEs for two reasons. First, while USDOT's Office of Civil Rights (DOCR) records the complaints and assigns identification numbers before routing them to FTA or FHWA for investigation, DOCR's records may not include complaints filed directly with those agencies. Second, DBEs may file complaints of discrimination under the DBE regulations or regulations issued under title VI of the Civil Rights Act of 1964; however, DOCR does not record which title VI complaints are filed by DBEs. Similarly, FTA does not separately track the title VI complaints filed by DBEs. Because of these two problems, information provided by USDOT would likely understate the number of complaints of discrimination filed by DBEs.

In addition, USDOT could not provide the total number of investigations launched as a result of the written discrimination complaints filed by DBEs or information on the outcomes of these investigations. In order to determine whether the discrimination complaints filed by DBEs have merit, the number of investigations launched and the outcomes of the investigations are critical pieces

[44] We did not review USDOT's response to individual written complaints of discrimination.

of information. USDOT officials stated they do not track the number of investigations of written discrimination complaints filed by DBEs or the number of times discrimination was found through their investigations. To gather this type of information, USDOT officials stated one would need to go through each case file individually – nearly 100 over the last several years, not including title VI complaints.

We also asked the states and transit authorities we surveyed about written discrimination complaints filed by DBEs in fiscal years 1999 and 2000. Eighty-one percent of the respondents reported that they had not received any written discrimination complaints filed by DBEs during this period. Nineteen percent of the states and transit authorities reported that they had received a total of 31 written discrimination complaints filed by DBEs in 1999 and 2000. Of the 31 complaints filed, 29 had been investigated. Four of these investigations resulted in findings of discrimination. While the number of complaints filed by DBEs with states and transit authorities may seem low, it is important to note that DBEs that believe they have been the victims of discrimination have several options and may have elected to pursue action elsewhere. For example, a DBE could file a complaint with the responsible state or transit authority, USDOT, and/or the courts. In addition, USDOT officials stated that the number of written discrimination complaints filed (at any level) probably understates the level of discrimination for two reasons. Specifically, DBEs may choose not to file complaints because they believe the process is too time-consuming or burdensome or because they fear retribution (i.e., they would be denied future work).

Other Barriers May Limit DBEs' Ability to Compete for Contracts

Other factors may also limit the ability of DBEs to compete for USDOT-assisted contracts. However, there was little agreement among the officials we spoke with as to whether these factors are due to discrimination or the nature of small businesses. According to our survey results, 80 percent of the states and transit authorities responding had not conducted any type of analysis on this subject.[45] In addition, neither USDOT, nor SBA, nor the industry groups we contacted had conducted any type of study on factors that may limit the ability of DBEs to obtain contracts.[46] The industry officials we spoke with often cited such factors as contract bundling; limited access to bonding, working capital, and credit; and prequalification requirements.

The most common factors cited as limiting DBEs' ability to compete for contracts are a lack of working capital and limited access to credit and bonding. For example, according to an association representing small minority-owned businesses, DBEs frequently lack the capital needed to finance jobs without drawing on credit and are denied credit because they lack sufficient cash flow. Since these factors are widely perceived as limiting the ability of DBEs to compete for contracts, USDOT has established

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[45] Eight of the 17 states and transit authorities that had conducted such analyses reported that the analyses were included in their disparity studies.

[46] The 1996 Department of Justice review contained information on these factors.

a number of services, including short-term lending and bonding assistance, to help overcome these barriers.

Another factor often cited as a barrier to DBEs' ability to compete for contracts is contract bundling. Contract bundling is the consolidation of two or more procurement requirements previously provided or performed under separate, smaller contracts into a solicitation of offers for a single contract.[47] The resulting contract is likely to be unsuitable for award to small businesses, such as DBEs, because of (1) the diversity, size, or specialized nature of the elements of the performance specified; (2) the aggregate dollar value of the anticipated award; (3) the geographic dispersion of contract performance sites; or (4) any combination of these three factors. USDOT officials stated that they believe contract bundling is one of the largest barriers for DBEs in competing for transportation contracts. GAO recently reported that there is limited government-wide data on the extent of contract bundling and its effect on small businesses.[48]

Prequalification requirements are also cited as a barrier for DBEs. Most states require that firms competing for prime contracts be prequalified, meaning they must prove to the state that they are capable of performing contracts. For example, firms must show that they have an adequate line of credit and are bonded. According to

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[47] A similar concept is contract consolidation. Contract consolidation occurs when agencies combine existing contracts into fewer contracts as a means of streamlining as well as reducing procurement and contract administration costs.

[48] *Small Businesses: Limited Information Available on Contract Bundling's Extent and Effects* (GAO/GGD-00-82, Mar. 31, 2000).

USDOT officials, these requirements can hurt DBEs because the firms may not have the working capital and access to credit required for prequalification.

Impact of the DBE Program

Several measures could be used to help determine the impact of the DBE program. TEA-21 directed us to analyze:

- the impact of the DBE program on costs, including the costs of administering the program;
- the impact of the DBE program on competition and the creation of jobs; and
- the impact of discontinuing federal or non-federal DBE programs on DBEs.

Impact of the DBE Program on Costs, Competition, and the Creation of Jobs

USDOT, states and transit authorities incur costs in implementing and administering the DBE program. USDOT estimates that it incurred about $6 million in costs (including salaries and training expenses) to administer the DBE program for highways and transit authorities in fiscal year 2000.[49] Sixty-nine percent of the states

[49] According to USDOT, the costs incurred in fiscal year 2000 are higher than typical because of the work associated with the new regulations, such as training and reviews of recipients' new programs and goal-setting methods. USDOT indicated that, during a typical year, it would incur about $3.5 million to administer the DBE program.

and transit authorities responding to our survey estimated that they incurred a total of about $44 million in costs, including certification costs, to administer the DBE program in fiscal year 2000. The costs incurred ranged from a high of $4.5 million to a low of about $10,000. In addition, 13 states and transit authorities incurred a total of about $250,000 in litigation costs in fiscal year 2000 that they attributed to the federal DBE program. Although it has been asserted that the DBE program increases the costs of contracting (referred to as additional construction costs), 99 percent of the states and transit authorities we surveyed had not conducted a study or analysis to determine whether the DBE program has an impact on their contract costs.[50] USDOT has also not conducted such an analysis.

Almost none of the states and transit authorities responding to our survey have analyzed the impact of the DBE program on competition and the creation of jobs. Nor has USDOT conducted this type of analysis. According to USDOT officials and representatives from transportation associations, the DBE program does not create jobs; rather it shifts jobs to individuals who might not receive the jobs otherwise. As USDOT officials noted, USDOT-assisted contracts will be let regardless of the DBE program, and the program encourages greater racial and gender diversity within transportation contracting.[51]

[50] The Dallas Area Rapid Transit (DART) reported that it is collecting information to determine the overall costs of unbundling larger contracts.

[51] We did not look at the make-up and number of employees that work for DBEs compared with non-DBEs.

However, there is less agreement about the effects of the program on competition. Officials from USDOT and a minority business group stated that the DBE program does not hurt competition, noting that the DBE program does not use quotas and that DBEs must compete with non-DBEs to receive USDOT-assisted contracts. Moreover, these officials commented that the DBE program enhances competition because it encourages greater participation by more firms. In contrast, representatives from transportation associations believe that the DBE program stifles competition in certain subcontracting areas (e.g., guardrail work) where there is an overconcentration of DBEs. Because of this overconcentration of DBEs, according to the transportation associations, non-DBEs do not have an opportunity to work in those fields. Although USDOT does not have data indicating that overconcentration is a serious, nationwide problem, the new regulations authorized states and transit authorities to remedy situations in which an overconcentration of DBEs is limiting non-DBEs' ability to compete for contracts, such as varying the use of contract goals in these areas.

Impact of Discontinuing Federal and Nonfederal DBE Programs

Limited data prevent a thorough assessment of the impact of suspending or repealing (discontinuing) federal or nonfederal DBE programs on DBEs' participation in transportation contracting. As evidence that the DBE program is needed, supporters often cite statistics on DBEs' participation in transportation contracting after minority- and women-owned business contracting programs are

discontinued. An example used during the congressional debate preceding the passage of TEA-21 was the effect of discontinuing the state of Michigan's minority business contracting program in 1989. According to evidence cited during the debate, within 9 months of the suspension, the proportion of state highway dollars awarded to minority-owned businesses had dropped from 5 percent to 0 percent, while the proportion of state highway dollars awarded to women-owned businesses had declined from about 10 percent to 1 percent. Moreover, these new low rates of participation in state transportation contracting by minority-and women-owned businesses were contrasted with these firms' participation rates in USDOT-assisted contracts, which were significantly higher.[52] USDOT has not conducted studies or analyses measuring the impact of discontinuing federal or nonfederal DBE programs.

Most states and transit authorities that participated in federal DBE programs or nonfederal minority business enterprise and women business enterprise (MBE/WBE) contracting programs that were discontinued could not provide data that would allow us to thoroughly evaluate the impact of that action. For example, we identified one state and one transit authority that had discontinued

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[52] Michigan could not provide us with minority- and women-owned business participation data in state highway contracting for the years immediately before and after it discontinued its program. Furthermore, Michigan officials stated that the analysis showing the decline that is often cited was a one-time-only analysis and that the analysis is no longer available. Consequently, we cannot verify the numbers cited during the debate.

their federal DBE programs as a result of a court order.[53] However, only the state could provide participation data that would allow us to evaluate the impact of discontinuing the federal DBE program. We also identified 10 states and transit authorities that had participated in nonfederal MBE/WBE programs that were discontinued prior to 2000.[54] Only one state could provide sufficient data for us to evaluate the impact of the action. Conversely, officials from six states and transit authorities, including Michigan, told us that participation data for minorities and women in state transportation contracting for the years immediately before and after the discontinuance of their nonfederal MBE/WBE programs were not available. In addition, few of the states and transit authorities could provide equivalent data on non-MBE/WBEs. This information is important to determine whether changes in MBE/WBEs' participation rates in state transportation contracting were similar to the changes in the participation rates of non-MBE/WBEs or unique to the MBE/WBE

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[53] In 1998, Minnesota's Department of Transportation (MNDOT) discontinued its federal DBE program when it was declared unconstitutional; however, MNDOT reinstituted its federal program under the new DBE regulations in 2000. The Metropolitan Transit Authority of Harris County in Houston discontinued its federal DBE program in 1996 when its constitutionality was called into question. In 1998, it established a race and gender-neutral small business program, which FTA approved as its federal DBE program.

[54] Two other transit authorities had participated in minority- and women-owned business contracting programs that were discontinued in 2000. We did not try to obtain information from these two transit authorities because not enough time has elapsed for us to evaluate the impact of this action.

community. Consequently, we could not evaluate the impact of discontinuing these programs.

Two states – Minnesota and Louisiana – were able to provide sufficient data to assess the impact of discontinuing a federal and nonfederal program, respectively. We measured DBEs' and MBE/WBEs' participation using two indicators – (1) the number of transportation contracts awarded and (2) the dollar amounts awarded through those contracts. The participation data from these states suggest that discontinuing these programs had a negative impact on DBEs' and MBE/WBEs' participation in transportation contracting. For example, in Minnesota, DBEs' participation in federal transportation contracting remained relatively stable from 1995 to 1998. However, after the discontinuance of Minnesota's federal DBE program in 1998, DBEs' participation in federal transportation contracting dramatically declined. (See fig. 2. [Figure 2 omitted in printing])

Similarly, the data provided by Louisiana indicate that MBE/WBEs' participation in transportation contracting declined after Louisiana's nonfederal program was discontinued. As shown in figure 3 [Figure 3 omitted in printing], MBE/WBEs' participation in state transportation contracting increased from 1992 to 1995. In 1996, the year the nonfederal program was discontinued, the participation rate of MBE/WBEs in state transportation contracting dropped and continued to decline over the next 4 years.[55] An official from Louisiana attributed the decline

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[55] We also obtained data on DBE participation in Louisiana's federal DBE program from 1995 to 2000. In our

in MBE/WBEs' participation in state transportation contracting to the removal of affirmative action requirements on state funded projects and the realization by contractors that efforts to include MBE/WBEs were no longer necessary.

Conclusions

The Congress identified and directed us to collect information that would shed light on the impact of the DBE program across the nation – including information on who benefits from the program, the financial status of the DBE community compared with that of the non-DBE community, and degree to which DBEs participate in transportation contracting. However, much of this information is not readily available from USDOT, states and transit authorities, and industry groups. Without this information it is impossible to define the universe of DBEs, compare them with the transportation contracting community as a whole or gain a clear understanding of the overall impact of the DBE program. In some cases, USDOT has mechanisms in place, such as its quarterly reporting requirement, that could be used to collect additional information, including the annual gross receipts of DBEs and non-DBEs as well as non-DBEs' participation in subcontracting. In other cases, new mechanisms to collect or process the information are needed such as a method for determining the total number of certified DBEs

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review of data on DBE and MBE/WBE participation in federally-assisted and state contracting, we did not observe a shift of MBE/WBEs to federally-assisted contracts after the Louisiana's MBE/WBE program was discontinued.

nationwide. USDOT could also do more to analyze the information that is currently collected. By not systematically tracking and evaluating the total number of discrimination complaints filed by DBEs, the number of investigations launched, and the outcomes of the investigations, USDOT misses an opportunity to obtain information that could be used to identify trends and problem areas that may need attention. USDOT could also identify ways to improve the effectiveness of its own policies and guidance to states and transit authorities, and ultimately DBEs, by collecting and analyzing the information that the Congress has identified. Such information would help USDOT contribute to an informed congressional debate on the impact of the DBE program in connection with its reauthorization in 2003 and more effectively administer the program.

USDOT could also look for ways to provide more guidance to the states and transit authorities that are implementing the DBE program. Specifically, USDOT's new regulations put a mechanism in place for setting DBE goals and identified Census Bureau data and DBE directories, bidders lists, and disparity studies as data sources that states and transit authorities could use in setting these goals. However, in our review of disparity studies, we identified problems with these data sources that should be avoided or mitigated to help ensure that goals set by states and transit authorities are based on the level of DBE participation expected in the absence of discrimination – specifically, a level consistent with the availability of ready, willing, and able DBEs in the relevant market. USDOT provided examples of how to set DBE goals in its regulations, but has issued minimal guidance

to the states and transit authorities on how to avoid the types of data and methodological problems we identified and ensure that the data sources used to set goals are as reliable as possible. USDOT could provide additional guidance to help states and transit authorities carry out the program.

Recommendations for Executive Action

To assist USDOT in administering the DBE program and to help inform the Congress about the impact of the program, we recommend that the Secretary of Transportation take the following steps:

- Develop and implement a method for states and transit authorities to assign unique identification numbers to DBEs so that the total number of DBEs certified nationwide can be determined.

- Amend the quarterly reporting requirements for states and transit authorities to include information on the annual gross receipts of DBEs and non-DBEs and the number and dollar amount of the subcontracts awarded to non-DBEs. This information could be used to gain a more complete understanding of the participation rate of DBEs in subcontracting and of their financial status compared with other transportation contracting firms. Furthermore, USDOT should compile, analyze, and publish (in aggregate format) the information collected in the quarterly reports.

- Compile and analyze data on written complaints of discrimination filed by DBEs with USDOT in order to

(1) determine trends in the number and types of complaints filed and (2) identify problem areas that require action.

- Periodically compile information on DBEs, through a survey or other appropriate mechanism, to better understand the types of programs needed to assist these firms.

To better assist states and transit authorities in implementing the DBE program and help ensure that DBE participation goals reflect the availability of ready, willing, and able DBEs in the relevant market, we recommend that the Secretary of Transportation provide specific guidance to states and transit authorities on strategies to mitigate the potential problems associated with using Census Bureau data and DBE directories, disparity studies, and bidders lists to set their DBE goals.

We recognize that the implementation of these recommendations may result in some additional costs for USDOT, states, and transit authorities. However, given existing data collection requirements and the benefits associated with these recommendations, we believe such costs are warranted.

Agency Comments and Our Evaluation

We provided USDOT with a draft of this report for review and comment. On May 1, 2001, the Assistant Secretary for Administration responded for USDOT. USDOT did not comment on our recommendations. Instead, USDOT offered comments to clarify the role of disparity studies in the DBE program, the evidentiary value of disparity studies, the need for states and transit authorities to use the best available data in DBE goal-setting, and the status of DBE and non-DBE participation

data. During recent meetings and discussions, USDOT provided similar comments, which we considered and incorporated where appropriate. Therefore, we believe that the majority of USDOT's comments are already reflected in the report. USDOT's comments and our responses are located in Appendix IV.

We conducted our review from August 2000 through April 2001 in accordance with generally accepted government auditing standards.

We are sending copies of this report to congressional committees with responsibilities for the activities discussed in this report; the Honorable Norman Y. Mineta, Secretary of Transportation; the Honorable Mitchell Daniels, Director of the Office of Management and Budget; Hiram Walker, Acting Deputy Administrator, Federal Transit Administration; and Vincent F. Schimmoller, Deputy Executive Director, Federal Highway Administration. We will make copies available to others upon request.

If you or your staff have any questions about this report, please call me at (202) 512-2834. Key contributors to this report are listed in appendix V.

Sincerely yours,

/s/ John H. Anderson, Jr.
John H. Anderson, Jr.
Managing Director, Physical Infrastructure Issues

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13 C.F.R. § 124.103 (2001) Who is socially disadvantaged?

(a) *General.* Socially disadvantaged individuals are those who have been subjected to racial or ethnic prejudice or cultural bias within American society because of their identities as members of groups and without regard to their individual qualities. The social disadvantage must stem from circumstances beyond their control.

(b) *Members of designated groups.* (1) There is a rebuttable presumption that the following individuals are socially disadvantaged: Black Americans; Hispanic Americans; Native Americans (American Indians, Eskimos, Aleuts, or Native Hawaiians); Asian Pacific Americans (persons with origins from Burma, Thailand, Malaysia, Indonesia, Singapore, Brunei, Japan, China (including Hong Kong), Taiwan, Laos, Cambodia (Kampuchea), Vietnam, Korea, The Philippines, U.S. Trust Territory of the Pacific Islands (Republic of Palau), Republic of the Marshall Islands, Federated States of Micronesia, the Commonwealth of the Northern Mariana Islands, Guam, Samoa, Macao, Fiji, Tonga, Kiribati, Tuvalu, or Nauru); Subcontinent Asian Americans (persons with origins from India, Pakistan, Bangladesh, Sri Lanka, Bhutan, the Maldives Islands or Nepal); and members of other groups designated from time to time by SBA according to procedures set forth at paragraph (d) of this section. Being born in a country does not, by itself, suffice to make the birth country an individual's country of origin for purposes of being included within a designated group.

(2) An individual must demonstrate that he or she has held himself or herself out, and is currently identified

by others, as a member of a designated group if SBA requires it.

(3) The presumption of social disadvantage may be overcome with credible evidence to the contrary. Individuals possessing or knowing of such evidence should submit the information in writing to the Associate Administrator for 8(a) BD (AA/8(a)BD) for consideration.

(c) *Individuals not members of designated groups.* (1) An individual who is not a member of one of the groups presumed to be socially disadvantaged in paragraph (b)(1) of this section must establish individual social disadvantage by a preponderance of the evidence.

(2) Evidence of individual social disadvantage must include the following elements:

(i) At least one objective distinguishing feature that has contributed to social disadvantage, such as race, ethnic origin, gender, physical handicap, long-term residence in an environment isolated from the mainstream of American society, or other similar causes not common to individuals who are not socially disadvantaged;

(ii) Personal experiences of substantial and chronic social disadvantage in American society, not in other countries; and

(iii) Negative impact on entry into or advancement in the business world because of the disadvantage. SBA will consider any relevant evidence in assessing this element. In every case, however, SBA will consider education, employment and business history, where applicable, to see if the totality of circumstances shows disadvantage in entering into or advancing in the business world.

(A) *Education.* SBA considers such factors as denial of equal access to institutions of higher education, exclusion from social and professional association with students or teachers, denial of educational honors rightfully earned, and social patterns or pressures which discouraged the individual from pursuing a professional or business education.

(B) *Employment.* SBA considers such factors as unequal treatment in hiring, promotions and other aspects of professional advancement, pay and fringe benefits, and other terms and conditions of employment; retaliatory or discriminatory behavior by an employer; and social patterns or pressures which have channelled the individual into nonprofessional or non-business fields.

(C) *Business history.* SBA considers such factors as unequal access to credit or capital, acquisition of credit or capital under commercially unfavorable circumstances, unequal treatment in opportunities for government contracts or other work, unequal treatment by potential customers and business associates, and exclusion from business or professional organizations.

(d) *Socially disadvantaged group inclusion.* (1) *General.* Representatives of an identifiable group whose members believe that the group has suffered chronic racial or ethnic prejudice or cultural bias may petition SBA to be included as a presumptively socially disadvantaged group under paragraph (b)(1) of this section. Upon presentation of substantial evidence that members of the group have been subjected to racial or ethnic prejudice or cultural bias because of their identity as group members

and without regard to their individual qualities, SBA will publish a notice in the Federal Register that it has received and is considering such a request, and that it will consider public comments.

(2) *Standards to be applied.* In determining whether a group has made an adequate showing that it has suffered chronic racial or ethnic prejudice or cultural bias for the purposes of this section, SBA must determine that:

(i) The group has suffered prejudice, bias, or discriminatory practices;

(ii) Those conditions have resulted in economic deprivation for the group of the type which Congress has found exists for the groups named in the Small Business Act; and

(iii) Those conditions have produced impediments in the business world for members of the group over which they have no control and which are not common to small business owners generally.

(3) *Procedure.* The notice published under paragraph (d)(1) of this section will authorize a specified period for the receipt of public comments supporting or opposing the petition for socially disadvantaged group status. If appropriate, SBA may hold hearings. SBA may also conduct its own research relative to the group's petition.

(4) *Decision.* In making a final decision that a group should be considered presumptively disadvantaged, SBA must find that a preponderance of the evidence demonstrates that the group has met the standards set forth in

paragraph (d)(2) of this section based on SBA's consideration of the group petition, the comments from the public, and any independent research it performs. SBA will advise the petitioners of its final decision in writing, and publish its conclusion as a notice in the Federal Register. If appropriate, SBA will amend paragraph (b)(1) of this section to include a new group.

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13 C.F.R. § 124.104 (2001) Who is economically disadvantaged?

(a) *General.* Economically disadvantaged individuals are socially disadvantaged individuals whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities as compared to others in the same or similar line of business who are not socially disadvantaged.

(b) *Submission of narrative and financial information.* (1) Each individual claiming economic disadvantage must describe it in a narrative statement, and must submit personal financial information.

(2) When married, an individual claiming economic disadvantage also must submit separate financial information for his or her spouse, unless the individual and the spouse are legally separated.

(c) *Factors to be considered.* In considering diminished capital and credit opportunities, SBA will examine factors relating to the personal financial condition of any individual claiming disadvantaged status, including personal income for the past two years (including bonuses

and the value of company stock given in lieu of cash), personal net worth, and the fair market value of all assets, whether encumbered or not. SBA will also consider the financial condition of the applicant compared to the financial profiles of small businesses in the same primary industry classification, or, if not available, in similar lines of business, which are not owned and controlled by socially and economically disadvantaged individuals in evaluating the individual's access to credit and capital. The financial profiles that SBA compares include total assets, net sales, pre tax profit, sales/working capital ratio, and net worth.

(1) *Transfers within two years.* (i) Except as set forth in paragraph (c)(1)(ii) of this section, SBA will attribute to an individual claiming disadvantaged status any assets which that individual has transferred to an immediate family member, or to a trust a beneficiary of which is an immediate family member, for less than fair market value, within two years prior to a concern's application for participation in the 8(a) BD program or within two years of a Participant's annual program review, unless the individual claiming disadvantaged status can demonstrate that the transfer is to or on behalf of an immediate family member for that individual's education, medical expenses, or some other form of essential support.

(ii) SBA will not attribute to an individual claiming disadvantaged status any assets transferred by that individual to an immediate family member that are consistent with the customary recognition of special occasions, such as birthdays, graduations, anniversaries, and retirements.

(iii) In determining an individual's access to capital and credit, SBA may consider any assets that the individual transferred within such two-year period described by paragraph (c)(1)(i) of this section that SBA does not consider in evaluating the individual's assets and net worth (e.g., transfers to charities).

(2) *Net worth.* For initial 8(a) BD eligibility, the net worth of an individual claiming disadvantage must be less than $250,000. For continued 8(a) BD eligibility after admission to the program, net worth must be less than $750,000. In determining such net worth, SBA will exclude the ownership interest in the applicant or Participant and the equity in the primary personal residence (except any portion of such equity which is attributable to excessive withdrawals from the applicant or Participant). Exclusions for net worth purposes are not exclusions for asset valuation or access to capital and credit purposes.

(i) A contingent liability does not reduce an individual's net worth.

(ii) The personal net worth of an individual claiming to be an Alaska Native will include assets and income from sources other than an Alaska Native Corporation and exclude any of the following which the individual receives from any Alaska Native Corporation: cash (including cash dividends on stock received from an ANC) to the extent that it does not, in the aggregate, exceed $2,000 per individual per annum; stock (including stock issued or distributed by an ANC as a dividend or distribution on stock); a partnership interest; land or an interest in land (including land or an interest in land

received from an ANC as a dividend or distribution on stock); and an interest in a settlement trust.

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13 C.F.R. § 124.1002 (2001) What is a Small Disadvantaged Business (SDB)?

(a) *Reliance on 8(a) criteria.* In determining whether a firm qualifies as an SDB, the criteria of social and economic disadvantage and other eligibility requirements established in subpart A of this part apply, including the requirements of ownership and control and disadvantaged status, unless otherwise provided in this subpart. Qualified Private Certifiers must use the 8(a) criteria applicable to ownership and control in determining whether a particular firm is actually owned and controlled by one or more individuals claiming disadvantaged status.

(b) *SDB eligibility criteria.* A small disadvantaged business (SDB) is a concern:

(1) Which qualifies as small under part 121 of this title for the size standard corresponding to the applicable four digit Standard Industrial Classification (SIC) code.

(i) For purposes of SDB certification, the applicable SIC code is that which relates to the primary business activity of the concern;

(ii) For purposes related to a specific Federal Government contract, the applicable SIC code is that assigned by the contracting officer to the procurement at issue;

(2) Which is at least 51 percent unconditionally owned by one or more socially and economically disadvantaged individuals as set forth in § 124.105. For the requirements relating to tribes and ANCs, NHOs, or CDCs, *see* §§ 124.109, 124.110, and 124.111, respectively.

(3) Except for tribes, ANCs, NHOs, and CDCs, whose management and daily business operations are controlled by one or more socially and economically disadvantaged individuals. For the requirements relating to tribes and ANCs, NHOs, or CDCs, *see* §§ 124.109, 124.110, and 124.111, respectively.

(4) Which, for purposes of SDB procurement mechanisms authorized by 10 U.S.C. 2323 (such as price evaluation adjustments, evaluation factors or subfactors, monetary subcontracting incentives, or SDB set-asides) relating to the Department of Defense, NASA and the Coast Guard only, has the majority of its earnings accruing directly to the socially and economically disadvantaged individuals.

(c) *Disadvantaged status.* In assessing the personal financial condition of an individual claiming economic disadvantage, his or her net worth must be less than $750,000 after taking into account the exclusions set forth in § 124.104(c)(2).

(d) *Additional eligibility criteria.* Except for tribes, ANCs, CDCs and NHOs, each individual claiming disadvantaged status must be a citizen of the United States.

(e) *Potential for success not required.* The potential for success requirement set forth in § 124.107 does not apply as an eligibility requirement for an SDB.

(f) *Joint ventures.* Joint ventures are permitted for SDB procurement mechanisms (such as price evaluation adjustments, evaluation factors or subfactors, monetary subcontracting incentives, or SDB set-asides), provided that the requirements set forth in this paragraph are met.

(1) The disadvantaged participant(s) to the joint venture must have:

(i) Received an SDB certification from SBA; or

(ii) Submitted an application for SDB certification to SBA or a Private Certifier, and must not have received a negative determination regarding that application.

(2) For purposes of this paragraph, the term joint venture means two or more concerns forming an association to engage in and carry out a single, specific business venture for joint profit. Two or more concerns that form an ongoing relationship to conduct business would not be considered "joint venturers" within the meaning of this paragraph, and would also not be eligible to be certified as an SDB. The entity created by such a relationship would not be owned and controlled by one or more socially and economically disadvantaged individuals. Each contract for which a joint venture submits an offer will be evaluated on a case by case basis.

(3) Except as set forth in 13 CFR 121.103(f)(3), a concern that is owned and controlled by one or more socially and economically disadvantaged individuals entering into a joint venture agreement with one or more other business concerns is considered to be affiliated with such other concern(s) for size purposes. If the exception does not apply, the combined annual receipts or

employees of the concerns entering into the joint venture must meet the applicable size standard corresponding to the SIC code designated for the contract.

(4) An SDB must be the managing venturer of the joint venture, and an employee of the managing venturer must be the project manager responsible for performance of the contract.

(5) The joint venture must perform any applicable percentage of work required of SDB offerors, and the SDB joint venturer(s) must perform a significant portion of the contract.

(g) *Ownership restrictions for non-disadvantaged individuals.* The ownership restrictions set forth in § 124.105 (g) and (h) for non-disadvantaged individuals and concerns do not apply for purposes of determining SDB eligibility.

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13 C.F.R. § 124.1014 (2001) How long does an SDB certification last?

(a) Once SBA certifies a firm to be an SDB by placing it on the list of qualified SDBs, the firm will generally remain on the SBA-maintained list of certified SDBs for a period of three years from the date of its certification.

(1) A firm's SDB certification will extend beyond three years where SBA finds the firm to be an SDB:

(i) On the merits in connection with a particular protest (*see* § 124.1023(h)(2));

(ii) In connection with an SBA-initiated SDB determination (*see* § 124.1016(a)(2)); or

(iii) As part of an 8(a) BD annual review.

(2) Where SBA finds a firm not to be an SDB in connection with an SDB protest, an SBA-initiated SDB determination, or an 8(a) BD annual review, SBA will immediately decertify the firm as an SDB and remove it from the qualified list of SDBs.

(b) A firm that graduates from the 8(a) BD program will remain on the list of certified SDBs for a period of three years from the date of its last annual review.

(c) To remain on the SDB register after three years, a firm whose status as an SDB has not been upheld in connection with a protest or an SBA-initiated SDB determination, or has not been certified as an eligible 8(a) Participant as part of an annual review, must submit a new application and receive a new certification.

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48 C.F.R. § 19.000 (2000) Scope of part.

(a) This part implements the acquisition-related sections of the Small Business Act (15 U.S.C. 631, *et seq.*), applicable sections of the Armed Services Procurement Act (10 U.S.C. 2302, *et seq.*), the Federal Property and Administrative Services Act (41 U.S.C. 252), section 7102 of the Federal Acquisition Streamlining Act of 1994 (Public Law 103-355), 10 U.S.C. 2323, and Executive Order 12138, May 18, 1979. It covers –

(1) The determination that a concern is eligible for participation in the programs identified in this part:

(2) The respective roles of executive agencies and the Small Business Administration (SBA) in implementing the programs;

(3) Setting acquisitions aside for exclusive competitive participation by small business concerns and HUBZone small business concerns, and sole source awards to HUBZone small business concerns;

(4) The certificate of competency program;

(5) The subcontracting assistance program;

(6) The "8(a)" program, under which agencies contract with the SBA for goods or services to be furnished under a subcontract by a small disadvantaged business concern;

(7) The use of women-owned small business concerns;

(8) The use of a price evaluation adjustment for small disadvantaged business concerns, and the use of a price evaluation preference for HUBZone small business concerns;

(9) The Small Disadvantaged Business Participation Program;

(10) The Very Small Business Pilot Program; and

(11) The use of veteran-owned small business concerns and service-disabled veteran-owned small business concerns.

(b) This part, except for Subpart 19.6, applies only inside the United States, its territories and possessions, Puerto Rico, the Trust Territory of the Pacific Islands, and the District of Columbia. Subpart 19.6 applies worldwide.

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48 C.F.R. § 19.201 (2000) General policy.

(a) It is the policy of the Government to provide maximum practicable opportunities in its acquisitions to small business, veteran-owned small business, service-disabled veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns. Such concerns must also have the maximum practicable opportunity to participate as subcontractors in the contracts awarded by any executive agency, consistent with efficient contract performance. The Small Business Administration (SBA) counsels and assists small business concerns and assists contracting personnel to ensure that a fair proportion of contracts for supplies and services is placed with small business.

(b) The Department of Commerce will determine on an annual basis, by North American Industry Classification System (NAICS) Industry Subsector, and region, if any, the authorized small disadvantaged business (SDB) procurement mechanisms and applicable factors (percentages). The Department of Commerce determination shall only affect solicitations that are issued on or after the effective date of the determination. The effective date of the Department of Commerce determination shall be no

less than 60 days after its publication date. The Department of Commerce determination shall not affect ongoing acquisitions. The SDB procurement mechanisms are a price evaluation adjustment for SDB concerns (see Subpart 19.11), an evaluation factor or subfactor for participation of SDB concerns (see 19.1202), and monetary subcontracting incentive clauses for SDB concerns (see 19.1203). The Department of Commerce determination shall also include the applicable factors, by NAICS Industry Subsector, to be used in the price evaluation adjustment for SDB concerns (see 19.1104). The General Services Administration shall post the Department of Commerce determination at http://www.arnet.gov/References/sdbadjustments.htm. The authorized procurement mechanisms shall be applied consistently with the policies and procedures in this subpart. The agencies shall apply the procurement mechanisms determined by the Department of Commerce. The Department of Commerce, in making its determination, is not limited to the SDB procurement mechanisms identified in this section where the Department of Commerce has found substantial and persuasive evidence of –

(1) A persistent and significant underutilization of minority firms in a particular industry, attributable to past or present discrimination; and

(2) A demonstrated incapacity to alleviate the problem by using those mechanisms.

(c) Heads of contracting activities are responsible for effectively implementing the small business programs within their activities, including achieving program goals. They are to ensure that contracting and technical

personnel maintain knowledge of small business program requirements and take all reasonable action to increase participation in their activities' contracting processes by these businesses.

(d) The Small Business Act requires each agency with contracting authority to establish an Office of Small and Disadvantaged Business Utilization (see section (k) of the Small Business Act). Management of the office shall be the responsibility of an officer or employee of the agency who shall, in carrying out the purposes of the Act –

(1) Be known as the Director of Small and Disadvantaged Business Utilization;

(2) Be appointed by the agency head;

(3) Be responsible to and report directly to the agency head or the deputy to the agency head;

(4) Be responsible for the agency carrying out the functions and duties in sections 8, 15, and 31 of the Small Business Act.

(5) Work with the SBA procurement center representative to –

(i) Identify proposed solicitations that involve bundling;

(ii) Facilitate small business participation as contractors including small business contract teams, where appropriate; and

(iii) Facilitate small business participation as subcontractors and suppliers where participation by small business concerns as contractors is unlikely;

(6) Assist small business concerns in obtaining payments under their contracts, late payment, interest penalties, or information on contractual payment provisions;

(7) Have supervisory authority over agency personnel to the extent that their functions and duties relate to sections 8, 15, and 31 of the Small Business Act.

(8) Assign a small business technical advisor to each contracting activity within the agency to which the SBA has assigned a representative (see 19.402) –

(i) Who shall be a full-time employee of the contracting activity, well qualified, technically trained, and familiar with the supplies or services contracted for by the activity; and

(ii) Whose principal duty is to assist the SBA's assigned representative in performing functions and duties relating to sections 8, 15, and 31 of the Small Business Act;

(9) Cooperate and consult on a regular basis with the SBA in carrying out the agency's functions and duties in sections 8, 15, and 31 of the Small Business Act;

(10) Make recommendations in accordance with agency procedures as to whether a particular acquisition should be awarded under Subpart 19.5 as a small business set-aside, under Subpart 19.8 as a Section 8(a) award, or under Subpart 19.13 as a HUBZone set-aside.

(e) Small Business Specialists must be appointed and act in accordance with agency regulations.

(f)(1) Each agency shall designate, at levels it determines appropriate, personnel responsible for determining whether, in order to achieve the contracting agency's goal for SDB concerns, the use of the SDB mechanism in Subpart 19.11 has resulted in an undue burden on non-SDB firms in one of the Industry Subsectors and regions identified by Department of Commerce following paragraph (b) of this section, or is otherwise inappropriate. Determinations under this subpart are for the purpose of determining future acquisitions and shall not affect ongoing acquisitions. Requests for a determination, including supporting rationale, may be submitted to the agency designee. If the agency designee makes an affirmative determination that the SDB mechanism has an undue burden or is otherwise inappropriate, the determination shall be forwarded through agency channels to the OFPP, which shall review the determination in consultation with the Department of Commerce and the Small Business Administration. At a minimum, the following information should be included in any submittal:

(i) A determination of undue burden or other inappropriate effect, including proposed corrective action.

(ii) The Industry Subsector affected.

(iii) Supporting information to justify the determination, including, but not limited to, dollars and percentages of contracts awarded by the contracting activity under the affected Industry Subsector for the previous two fiscal years and current fiscal year to date for –

(A) Total awards;

(B) Total awards to SDB concerns;

(C) Awards to SDB concerns awarded contracts under the SDB price evaluation adjustment where the SDB concerns would not otherwise have been the successful offeror;

(D) Number of successful and unsuccessful SDB offerors; and

(E) Number of successful and unsuccessful non-SDB offerors.

(iv) A discussion of the pertinent findings, including any peculiarities related to the industry, regions or demographics.

(v) A discussion of other efforts the agency has undertaken to ensure equal opportunity for SDBs in contracting with the agency.

(2) After consultation with OFPP, or if the agency does not receive a response from OFPP within 90 days after notice is provided to OFPP, the contracting agency may limit the use of the SDB mechanism in Subpart 19.11 until the Department of Commerce determines the updated price evaluation adjustment, as required by this section. This limitation shall not apply to solicitations that already have been synopsized.

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48 C.F.R. § 19.702 (2000) Statutory requirements.

Any contractor receiving a contract for more than the simplified acquisition threshold must agree in the contract that small business, veteran-owned small business, service-disabled veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns will have the maximum practicable opportunity to participate in contract performance consistent with its efficient performance. It is further the policy of the United States that its prime contractors establish procedures to ensure the timely payment of amounts due pursuant to the terms of their subcontracts with small business, veteran-owned small business, service-disabled veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns.

(a) Except as stated in paragraph (b) of this section, Section 8(d) of the Small Business Act (15 U.S.C. 637(d)) imposes the following requirements regarding subcontracting with small businesses and small business subcontracting plans:

(1) In negotiated acquisitions, each solicitation of offers to perform a contract or contract modification, that individually is expected to exceed $500,000 ($1,000,000 for construction) and that has subcontracting possibilities, shall require the apparently successful offeror to submit an acceptable subcontracting plan. If the apparently successful offeror fails to negotiate a subcontracting plan acceptable to the contracting officer within the time limit prescribed by the contracting officer, the offeror will be ineligible for award.

(2) In sealed bidding acquisitions, each invitation for bids to perform a contract or contract modification, that individually is expected to exceed $500,000 ($1,000,000 for construction) and that has subcontracting possibilities, shall require the bidder selected for award to submit a subcontracting plan. If the selected bidder fails to submit a plan within the time limit prescribed by the contracting officer, the bidder will be ineligible for award.

(b) Subcontracting plans (see subparagraphs (a)(1) and (2) of this section) are not required –

(1) From small business concerns;

(2) For personal services contracts;

(3) For contracts or contract modifications that will be performed entirely outside of any State, territory, or possession of the United States, the District of Columbia, and the Commonwealth of Puerto Rico; or

(4) For modifications to contracts within the general scope of the contract that do not contain the clause at 52.219-8, Utilization of Small Business Concerns (or equivalent prior clauses; *e.g.*, contracts awarded before the enactment of Public Law 95-507).

(c) As stated in 15 U.S.C. 637(d)(8), any contractor or subcontractor failing to comply in good faith with the requirements of the subcontracting plan is in material breach of its contract. Further, 15 U.S.C. 637(d)(4)(F) directs that a contractor's failure to make a good faith effort to comply with the requirements of the subcontracting plan shall result in the imposition of liquidated damages.

(d) As authorized by 15 U.S.C. 637(d)(11), certain costs incurred by a mentor firm in providing developmental assistance to a protégé firm under the Department of Defense Pilot Mentor-Protégé Program, may be credited as subcontract awards to a small disadvantaged business for the purpose of determining whether the mentor firm attains a small disadvantaged business goal under any subcontracting plan entered into with any executive agency. However, the mentor-protégé agreement must have been approved by the –

Office of Small and Disadvantaged Business
Utilization
Office of the Under Secretary of Defense
(Acquisition, Technology and Logistics)
1777 N. Kent Street
Suite 9100
Arlington, VA 22209

before developmental assistance costs may be credited against subcontracting goals. A list of approved agreements may be obtained at http://www.acq.osd.mil/sadbu/mentor_protege/ or by calling 1-800-553-1858.

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48 C.F.R. § 19.704 (2000) Subcontracting plan requirements.

(a) Each subcontracting plan required under 19.702(a)(1) and (2) must include –

(1) Separate percentage goals for using small business, veteran-owned small business, HUBZone small business, small disadvantaged business, and women-

owned small business concerns as subcontractors. Service-disabled veteran-owned small business concerns meet the definition of veteran-owned small business concerns, and offerors may include them within the subcontracting plan goal for veteran-owned small business concerns. A separate goal for service-disabled veteran-owned small business concerns is not required;

(2) A statement of the total dollars planned to be subcontracted and a statement of the total dollars planned to be subcontracted to small business, veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns;

(3) A description of the principal types of supplies and services to be subcontracted and an identification of types planned for subcontracting to small business, veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns;

(4) A description of the method used to develop the subcontracting goals;

(5) A description of the method used to identify potential sources for solicitation purposes;

(6) A statement as to whether or not the offeror included indirect costs in establishing subcontracting goals, and a description of the method used to determine the proportionate share of indirect costs to be incurred with small business, veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns;

(7) The name of an individual employed by the offeror who will administer the offeror's subcontracting program, and a description of the duties of the individual;

(8) A description of the efforts the offeror will make to ensure that small business, veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns have an equitable opportunity to compete for subcontracts;

(9) Assurances that the offeror will include the clause at 52.219-8, Utilization of Small Business Concerns (see 19.708(a)), in all subcontracts that offer further subcontracting opportunities, and that the offeror will require all subcontractors (except small business concerns) that receive subcontracts in excess of $500,000 ($1,000,000 for construction) to adopted a plan that complies with the requirements of the clause at 52.219-9, Small Business Subcontracting Plan (see 19.708(b));

(10) Assurances that the offeror will –

(i) Cooperate in any studies or surveys as may be required;

(ii) Submit periodic reports so that the Government can determine the extent of compliance by the offeror with the subcontracting plan;

(iii) Submit Standard Form (SF) 294, Subcontracting Report for Individual Contracts, and SF 295, Summary Subcontract Report, following the instructions on the forms or as provided in agency regulations; and

(iv) Ensure that its subcontractors agree to submit SF 294 and SF 295; and

(11) A description of the types of records that will be maintained concerning procedures adopted to comply with the requirements and goals in the plan, including establishing source lists; and a description of the offeror's efforts to locate small business, veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns and to award subcontracts to them.

(b) Contractors may establish, on a plant or division-wide basis, a master plan (see 19.701) that contains all the elements required by the clause at 52.219-9, Small Business Subcontracting Plan, except goals. Master plans shall be effective for a 3-year period after approval by the contracting officer; however, it is incumbent upon contractors to maintain and update master plans. Changes required to update master plans are not effective until approved by the contracting officer. A master plan, when incorporated in an individual plan, shall apply to that contract throughout the life of the contract.

(c) For multiyear contracts or contracts containing options, the cumulative value of the basic contract and all options is considered in determining whether a subcontracting plan is necessary (see 19.705-2(a)). If a plan is necessary and the offeror is submitting an individual contract plan, the plan shall contain all the elements required by paragraph (a) of this section and shall contain separate statements and goals for the basic contract and for each option.

(d) A commercial plan (as defined in 19.701) is the preferred type of subcontracting plan for contractors furnishing commercial items. The contractor shall –

(1) Submit the commercial plan to either the first contracting officer awarding a contract subject to the plan during the contractor's fiscal year, or, if the contractor has ongoing contracts with commercial plans, to the contracting officer responsible for the contract with the latest completion date. The contracting officer shall negotiate the commercial plan for the Government. The approved commercial plan shall remain in effect during the contractor's fiscal year for all Government contracts in effect during that period; and

(2) Submit a new commercial plan, 30 working days before the end of the fiscal year, to the contracting officer responsible for the uncompleted Government contract with the latest completion date. The contractor must provide to each contracting officer responsible for an ongoing contract subject to the plan, the identity of the contracting officer that will be negotiating the new plan. When a new commercial plan is approved, the contractor shall provide a copy of the approved plan to each contracting officer responsible for an ongoing contract that is subject to the plan.

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48 C.F.R. § 19.705-4 (2000) Reviewing the subcontracting plan.

The contracting officer must review the subcontracting plan for adequacy, ensuring that the required information, goals, and assurances are included (see 19.704).

(a) No detailed standards apply to every subcontracting plan. Instead, the contracting officer must consider each plan in terms of the circumstances of the particular acquisition, including –

(1) Previous involvement of small business concerns as prime contractors or subcontractors in similar acquisitions;

(2) Proven methods of involving small business concerns as subcontractors in similar acquisitions;

(3) The relative success of methods the contractor intends to use to meet the goals and requirements of the plan, as evidenced by records maintained by contractors.

(b) If, under a scaled bid solicitation, a bidder submits a plan that does not cover each of the 11 required elements (see 19.704), the contracting officer shall advise the bidder of the deficiency and request submission of a revised plan by a specific date. If the bidder does not submit a plan that incorporates the required elements within the time allotted, the bidder shall be ineligible for award. If the plan, although responsive, evidences the bidder's intention not to comply with its obligations under the clause at 52.219-8, Utilization of Small Business Concerns, the contracting officer may find the bidder nonresponsible.

(c) In negotiated acquisitions, the contracting officer shall determine whether the plan is acceptable based on the negotiation of each of the 11 elements of the plan (see 19.704). Subcontracting goals should be set at a level that the parties reasonably expect can result from the offeror expending good faith efforts to use small business, veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business subcontractors to the maximum practicable extent. The contracting officer shall take particular care to ensure that the offeror has not submitted unreasonably low goals to minimize exposure to liquidated damages and to avoid the administrative burden of substantiating good faith efforts. Additionally, particular attention should be paid to the identification of steps that, if taken, would be considered a good faith effort. No goal should be negotiated upward if it is apparent that a higher goal will significantly increase the Government's cost or seriously impede the attainment of acquisition objectives. An incentive subcontracting clause (see 52.219-10, Incentive Subcontracting Program), may be used when additional and unique contract effort, such as providing technical assistance, could significantly increase subcontract awards to small business, veteran-owned small business, HUBZone small business, or women-owned small business concerns.

(d) In determining the acceptability of a proposed subcontracting plan, the contracting officer should take the following actions:

(1) Obtain information available from the cognizant contract administration officer, as provided for in 19.706(a), and evaluate the offeror's past performance in

awarding subcontracts for the same or similar products or services to small business, veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns. If information is not available on a specific type of product or service, evaluate the offeror's overall past performance and consider the performance of other contractors on similar efforts.

(2) In accordance with 15 U.S.C. 637(d)(4)(F)(iii), ensure that the goals offered are attainable in relation to –

(i) The subcontracting opportunities available to the contractor, commensurate with the efficient and economical performance of the contract;

(ii) The pool of eligible subcontractors available to fulfill the subcontracting opportunities; and

(iii) The actual performance of such contractor in fulfilling the subcontracting goals specified in prior plans.

(3) Ensure that the subcontracting goals are consistent with the offeror's cost or pricing data or information other than cost or pricing data.

(4) Evaluate the offeror's make-or-buy policy or program to ensure that it does not conflict with the offeror's proposed subcontracting plan and is in the Government's interest. If the contract involves products or services that are particularly specialized or not generally available in the commercial market, consider the offeror's current capacity to perform the work and the possibility of reduced subcontracting opportunities.

(5) Evaluate subcontracting potential, considering the offeror's make-or-buy policies or programs, the nature of the supplies or services to be subcontracted, the known availability of small business, veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns in the geographical area where the work will be performed, and the potential contractor's long-standing contractual relationship with its suppliers.

(6) Advise the offeror of available sources of information on potential small business, veteran-owned small business, service-disabled veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business subcontractors, as well as any specific concerns known to be potential subcontractors. If the offeror's proposed goals are questionable, the contracting officer must emphasize that the information should be used to develop a realistic and acceptable goals. The contracting officer should ensure that the contractor has considered the use of service-disabled veteran-owned small businesses in developing its veteran-owned small business goal (see 19.704(a)(1) and 52.219-9(d)(1)).

(7) Obtain advise and recommendations from the SBA procurement center representative (if any) and the agency small business specialist.

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48 C.F.R. § 19.705-5 (2000) Awards involving subcontracting plans.

(a) In making an award that requires a subcontracting plan, the contracting officer shall be responsible for the following:

(1) Consider the contractor's compliance with the subcontracting plans submitted on previous contracts as a factor in determining contractor responsibility.

(2) Assure that a subcontracting plan was submitted when required.

(3) Notify the SBA resident procurement center representative of the opportunity to review the proposed contract (including the plan and supporting documentation). The notice shall be issued in sufficient time to provide the representative a reasonable time to review the material and submit advisory recommendations to the contracting officer. Failure of the representative to respond in a reasonable period of time shall not delay contract award.

(4) Determine any fee that may be payable if an incentive is used in conjunction with the subcontracting plan.

(5) Ensure that an acceptable plan is incorporated into and made a material part of the contract.

(b) Letter contracts and similar undefinitized instruments, which would otherwise meet the requirements of 19.702(a)(1) and (2), shall contain at least a preliminary basic plan addressing the requirements of 19.704 and in such cases require the negotiation of the

final plan within 90 days after award or before definitization, whichever occurs first.

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48 C.F.R. § 19.705-7 (2000) Liquidated damages.

(a) Maximum practicable utilization of small business, veteran-owned small business (including service-disabled veteran-owned small business), HUBZone small business, small disadvantaged business, and women-owned small business concerns as subcontractors in Government contracts is a matter of national interest with both social and economic benefits. When a contractor fails to make a good faith effort to comply with a subcontracting plan, these objectives are not achieved, and 15 U.S.C. 637(d)(4)(F) directs that liquidated damages shall be paid by the contractor.

(b) The amount of damages attributable to the contractor's failure to comply shall be an amount equal to the actual dollar amount by which the contractor failed to achieve each subcontracting goal.

(c) If, at completion of the basic contract or any option, or in the case of a commercial plan, at the close of the fiscal year for which the plan is applicable, a contractor has failed to meet its subcontracting goals, the contracting officer shall review all available information for an indication that the contractor has not made a good faith effort to comply with the plan. If no such indication is found, the contracting officer shall document the file accordingly. If the contracting officer decides in accordance with paragraph (d) of this subsection that the

contractor failed to make a good faith effort to comply with its subcontracting plan, the contracting officer shall give the contractor written notice specifying the failure, advising the contractor of the possibility that the contractor may have to pay to the Government liquidated damages, and providing a period of 15 working days (or longer period as necessary) within which to respond. The notice shall give the contractor an opportunity to demonstrate what good faith efforts have been made before the contracting officer issues the final decision, and shall further state that failure of the contractor to respond may be taken as an admission that no valid explanation exists.

(d) In determining whether a contractor failed to make a good faith effort to comply with its subcontracting plan, a contracting officer must look to the totality of the contractor's actions, consistent with the information and assurances provided in its plan. The fact that the contractor failed to meet its subcontracting goals does not, in and of itself, constitute a failure to make a good faith effort. For example, notwithstanding a contractor's diligent effort to identify and solicit offers from small business, veteran-owned small business (including service-disabled veteran-owned small business), HUBZone small business, small disadvantaged business, and women-owned small business concerns, factors such as unavailability of anticipated sources or unreasonable prices may frustrate achievement of the contractor's goals. However, when considered in the context of the contractor's total effort in accordance with its plan, the following, though not all inclusive, may be considered as indicators of a failure to make a good faith effort: a failure to attempt to identify, contact, solicit, or consider

for contract award small business, veteran-owned small business (including service-disabled veteran-owned small business), HUBZone small business, small disadvantaged business, or women-owned small business concerns; a failure to designate and maintain a company official to administer the subcontracting program and monitor and enforce compliance with the plan; a failure to submit Standard Form (SF) 294, Subcontracting Report for Individual Contracts, or SF 295, Summary Subcontract Report, in accordance with the instructions on the forms or as provided in agency regulations; a failure to maintain records or otherwise demonstrate procedures adopted to comply with the plan; or the adoption of company policies or procedures that have as their objectives the frustration of the objectives of the plan.

(e) If, after consideration of all the pertinent data, the contracting officer finds that the contractor failed to make a good faith effort to comply with its subcontracting plan, the contracting officer shall issue a final decision to the contractor to that effect and require the payment of liquidated damages in an amount stated. The contracting officer's final decision shall state that the contractor has the right to appeal under the clause in the contract entitled Disputes.

(f) With respect to commercial plans approved under the clause at 52.219-9, Small Business Subcontracting Plan, the contracting officer that approved the plan shall –

(1) Perform the functions of the contracting officer under this subsection on behalf of all agencies with contracts covered by the commercial plan;

(2) Determine whether or not the goals in the commercial plan were achieved and, if they were not achieved, review all available information for an indication that the contractor has not made a good faith effort to comply with the plan, and document the results of the review;

(3) If a determination is made to assess liquidated damages, in order to calculate the assess the amount of damages, the contracting officer shall ask the contractor to provide –

(i) Contract numbers for the Government contracts subject to the plan;

(ii) The total Government sales during the contractor's fiscal year; and

(iii) The amount of payments made under the Government contracts subject to that plan that contributed to the contractor's total sales during the contractor's fiscal year; and

(4) When appropriate, assess liquidated damages on the Government's behalf, based on the pro rata share of subcontracting attributable to the Government contracts. For example: The contractor's total actual sales were $50 million and its actual subcontracting was $20 million. The Government's total payments under contracts subject to the plan contributing to the contractor's total sales were $5 million, which accounted for 10 percent of the contractor's total sales. Therefore, the pro rata share of subcontracting attributable to the Government contracts would be 10 percent of $20 million, or $2 million. To continue the example, if the contractor failed to

achieve its small business goal by 1 percent, the liquidated damages would be calculated as 1 percent of $2 million, or $20,000. The contracting officer shall make similar calculations for each category of small business where the contractor failed to achieve its goal and the sum of the dollars for all of the categories equals the amount of the liquidated damages to be assessed. A copy of the contracting officer's final decision assessing liquidated damages shall be provided to other contracting officers with contracts subject to the commercial plan.

(g) Liquidated damages shall be in addition to any other remedies that Government may have.

(h) Every contracting officer with a contract that is subject to a commercial plan shall include in the contract file a copy of the approved plan and a copy of the final decision assessing liquidating damages, if applicable.

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48 C.F.R. § 19.707 (2000) The Small Business Administration's role in carrying out the program.

(a) Under the program, the SBA may –

(1) Assist both Government agencies and contractors in carrying out their responsibilities with regard to subcontracting plans;

(2) Review (within 5 working days) any solicitation that meets the dollar threshold in 19.702(a)(1) or (2) before the solicitation is issued;

(3) Review (within 5 working days) before execution any negotiated contractual documents requiring a

subcontracting plan, including the plan itself, and submit recommendations to the contracting officer, which shall be advisory in nature; and

(4) Evaluate compliance with subcontracting plans, either on a contract-by-contract basis, or, in the case of contractors having multiple contracts, on an aggregate basis.

(b) The SBA is not authorized to –

(1) Prescribe the extent to which any contractor or subcontractor shall subcontract,

(2) Specify concerns to which subcontracts will be awarded, or

(3) Exercise any authority regarding the administration of individual prime contracts or subcontracts.

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48 C.F.R. Subpart 19.11 (2000) – Price Evaluation Adjustment for Small Disadvantaged Business Concerns

19.1101 General.

A price evaluation adjustment for small disadvantaged business concerns shall be applied as determined by the Department of Commerce (sec 19.201(b)). Joint ventures may qualify provided the requirements set forth in 13 CFR 124.1002(f) are met.

19.1102 Applicability.

(a) Use the price evaluation adjustment in competitive acquisitions in the authorized NAICS Industry Subsector.

(b) Do not use the price evaluation adjustment in acquisitions –

(1) That are less than or equal to the simplified acquisition threshold;

(2) That are awarded pursuant to the 8(a) Program;

(3) That are set aside for small business concerns;

(4) That are set aside for HUBZone small business concerns;

(5) Where price is not a selection factor so that a price evaluation adjustment would not be considered (*e.g.*, architect/engineer acquisitions); or

(6) Where all fair and reasonable offers are accepted (*e.g.*, the award of multiple award schedule contracts).

19.1103 Procedures

(a) Give offers from small disadvantaged business concerns a price evaluation adjustment by adding the factor determined by the Department of Commerce to all offers, except –

(1) Offers from small disadvantaged business concerns that have not waived the evaluation adjustment;

or, if a price evaluation adjustment for small disadvantaged business concerns is authorized on a regional basis, offers from small disadvantaged business concerns, whose address is in such a region, that have not waived the evaluation adjustment;

(2) An otherwise successful offer of eligible products under the Trade Agreements Act when the acquisition equals or exceeds the dollar threshold in 25.403;

(3) An otherwise successful offer where application of the factor would be inconsistent with a Memorandum of Understanding or other international agreement with a foreign government;

(4) For DoD, NASA, and Coast Guard acquisitions, an otherwise successful offer from a historically black college or university or minority institution; or

(5) For DoD acquisitions, an otherwise successful offer of qualifying country end products (see DFARS 225.000-70 and 252.225-7001).

(b) Apply the factor to a line item or a group of line items on which award may be made. Add other evaluation factors such as transportation costs or rent-free use of Government facilities to the offers before applying the price evaluation adjustment.

(c) Do not evaluate offers using the price evaluation adjustment when it would cause award, as a result of this adjustment, to be made at a price that exceeds fair market price by more than the factor as determined by the Department of Commerce (see 19.202-6(a)).

19.1104 Contract clause.

Insert the clause at 52.219-23, Notice of Price Evaluation Adjustment for Small Disadvantaged Business Concerns, in solicitations and contracts when the circumstances in 19.1101 and 19.1102 apply. If a price evaluation adjustment is authorized on a regional basis, the clause shall be included in the solicitation even if the place of performance is outside an authorized region. The contracting officer shall insert the authorized price evaluation adjustment factor. The clause shall be used with its Alternate I when the contracting officer determines that there are no small disadvantaged business manufacturers that can meet the requirements of the solicitation. The clause shall be used with its Alternate II when a price evaluation adjustment is authorized on a regional basis.

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48 C.F.R. § 19.1202 (2000) Evaluation factor or subfactor.

19.1202-1 General.

The extent of participation of SDB concerns in performance of the contract, in the NAICS Industry Subsector as determined by the Department of Commerce, and to the extent authorized by law, shall be evaluated consistent with this section. Participation in performance of the contract includes joint ventures, teaming arrangements, and subcontracts. Credit under the evaluation factor or subfactor is not available to SDB concerns that receive a price evaluation adjustment under Subpart 19.11. If an SDB concern waives the price evaluation adjustment at

Subpart 19.11, participation in performance of that contract includes the work expected to be performed by the SDB concern at the prime contract level.

19.1202-2 Applicability.

(a) Except as provided in paragraph (b) of this subsection, the extent of participation of SDB concerns in performance of the contract in the authorized NAICS Industry Subsector shall be evaluated in competitive, negotiated acquisitions expected to exceed $500,000 ($1,000,000 for construction).

(b) The extent of participation of SDB concerns in performance of the contract in the authorized NAICS Industry Subsector (see paragraph (a) of this subsection) shall not be evaluated in –

(1) Small business set-asides (see Subpart 19.5) and HUBZone set-asides (see Subpart 19.13);

(2) 8(a) acquisitions (see Subpart 19.8);

(3) Negotiated acquisitions where the lowest price technically acceptable source selection process is used (see 15.101-2); or

(4) Contract actions that will be performed entirely outside of any State, territory, or possession of the United States, the District of Columbia, and the Commonwealth of Puerto Rico.

19.1202-3 Considerations in developing an evaluation factor or subfactor.

In developing an SDB participation evaluation factor or subfactor for the solicitation, agencies may consider –

(a) The extent to which SDB concerns are specifically identified;

(b) The extent of commitment to use SDB concerns (for example, enforceable commitments are to be weighted more heavily than non-enforceable ones);

(c) The complexity and variety of the work SDB concerns are to perform;

(d) The realism of the proposal;

(e) Past performance of offerors in complying with subcontracting plan goals for SDB concerns and monetary targets for SDB participation; and

(f) The extent of participation of SDB concerns in terms of the value of the total acquisition.

19.1202-4 Procedures.

(a) The solicitation shall describe the SDB participation evaluation factor or subfactor. The solicitation shall require offerors to provide, with their offers, targets, expressed as dollars and percentages of total contract value, in each of the applicable, authorized NAICS Industry Subsector, and a total target for SDB participation by the contractor, including joint venture partners, and team members, and a total target for SDB participation by subcontractors. The solicitation shall require an SDB offeror that waives the SDB price evaluation adjustment

in the clause at 52.219-23, Notice of Price Evaluation Adjustment for Small Disadvantaged Business Concerns, to provide with its offer a target for the work that it intends to perform as the prime contractor. The solicitation shall state that any targets will be incorporated into and become part of any resulting contract. Contractors with SDB participation targets shall be required to report SDB participation.

(b) When an evaluation includes an SDB participation evaluation factor or subfactor that considers the extent to which SDB concerns are specifically identified, the SDB concerns considered in the evaluation shall be listed in the contract, and the contractor shall be required to notify the contracting officer of any substitutions of firms that are not SDB concerns.

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48 C.F.R. § 19.1203 (2000) Incentive subcontracting with small disadvantaged business concerns

The contracting officer may encourage increased subcontracting opportunities in the NAICS Industry Subsector as determined by the Department of Commerce for SDB concerns in negotiated acquisitions by providing monetary incentives (see the clause at 52.219-26, Small Disadvantaged Business Participation Program – Incentive Subcontracting, and 19.1204(c)). Monetary incentives shall be based on actual achievement as compared to proposed monetary targets for SDB subcontracting. The incentive subcontracting program is separate and distinct

from the establishment, monitoring, and enforcement of SDB subcontracting goals in a subcontracting plan.

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48 C.F.R. 19.1204 (2000) Solicitation provisions and contract clauses.

(a) The contracting officer may insert a provision substantially the same as the provision at 52.219-24, Small Disadvantaged Business Participation Program – Targets, in solicitations that consider the extent of participation of SDB concerns in performance of the contract. The contracting officer may vary the terms of this provision consistent with the policies in 19.1202-4.

(b) The contracting officer shall insert the clause at 52.219-25, Small Disadvantaged Business Participation Program – Disadvantaged Status and Reporting, in solicitations and contracts that consider the extent of participation of SDB concerns in performance of the contract.

(c) The contracting officer may, when contracting by negotiation, insert in solicitations and contracts containing the clause at 52.219-25, Small Disadvantaged Business Participation Program – Disadvantaged Status and Reporting, a clause substantially the same as the clause at 52.219-26, Small Disadvantaged Business Participation Program – Incentive Subcontracting, when authorized (see 19.1203). The contracting officer may include an award fee provision in lieu of the incentive; in such cases,

however, the contracting officer shall not use the clause at 52.219-26.

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48 C.F.R. § 52.219-26 (1999) Small Disadvantaged Business Participation Program – Incentive Subcontracting.

As prescribed in 19.1204(c), insert a clause substantially the same as the following:

SMALL DISADVANTAGED BUSINESS PARTICIPATION PROGRAM – INCENTIVE SUBCONTRACTING (JAN 1999)

(a) Of the total dollars it plans to spend under subcontracts, the Contractor has committed itself in its offer to try to award a certain amount to small disadvantaged business concerns in the Standard Industrial Classification (SIC) Major Groups as determined by the Department of Commerce.

(b) If the Contractor exceeds its total monetary target for subcontracting to small disadvantaged business concerns in the authorized SIC Major Groups, it will receive _____ [*Contracting Officer to insert the appropriate number between 0 and 10*] percent of the dollars in excess of the monetary target, unless the Contracting Officer determines that the excess was not due to the Contractor's efforts (*e.g.*, a subcontractor cost overrun caused the actual subcontract amount to exceed that estimated in the offer, or the excess was caused by the award of subcontracts that had been planned but had not been disclosed in the offer during contract negotiations). Determinations made under this paragraph are not subject to the Disputes clause of this contract.

(c) If this is a cost-plus-fixed-fee contract, the sum of the fixed fee and the incentive fee earned under this contract may not exceed the limitations in subsection 15.404-4 of the Federal Acquisition Regulation.

(End of clause)

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49 C.F.R. § 26.1 (2000) What are the objectives of this part?

This part seeks to achieve several objectives:

(a) To ensure nondiscrimination in the award and administration of DOT-assisted contracts in the Department's highway, transit, and airport financial assistance programs;

(b) To create a level playing field on which DBEs can compete fairly for DOT-assisted contracts;

(c) To ensure that the Department's DBE program is narrowly tailored in accordance with applicable law;

(d) To ensure that only firms that fully meet this part's eligibility standards are permitted to participate as DBEs;

(e) To help remove barriers to the participation of DBEs in DOT-assisted contracts;

(f) To assist the development of firms that can compete successfully in the marketplace outside the DBE program; and

(g) To provide appropriate flexibility to recipients of Federal financial assistance in establishing and providing opportunities for DBEs.

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49 C.F.R. § 26.3 (2000) To whom does this part apply?

(a) If you are a recipient of any of the following types of funds, this part applies to you:

(1) Federal-aid highway funds authorized under Titles I (other than Part B) and V of the Intermodal Surface Transportation Efficiency Act of 1991 (ISTEA). Pub. L. 102-240, 105 Stat. 1914, or Titles I, III, and V of the Transportation Equity Act for the 21st Century (TEA-21), Pub. L. 105-178, 112 Stat. 107.

(2) Federal transit funds authorized by Titles I, III, V and VI of ISTEA, Pub. L. 102-240 or by Federal transit laws in Title 49, U.S. Code, or Titles I, III, and V of the TEA-21, Pub. L. 105-178.

(3) Airport funds authorized by 49 U.S.C. 47101, *et seq.*

(b) [Reserved]

(c) If you are letting a contract, and that contract is to be performed entirely outside the United States, its territories and possessions, Puerto Rico, Guam, or the

Northern Marianas Islands, this part does not apply to the contract.

(d) If you are letting a contract in which DOT financial assistance does not participate, this part does not apply to the contract.

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49 C.F.R. § 26.5 (2000) What do the terms used in this part mean?

Affiliation has the same meaning the term has in the Small Business Administration (SBA) regulations, 13 CFR part 121.

(1) Except as otherwise provided in 13 CFR part 121, concerns are affiliates of each other when, either directly or indirectly:

(1) Except as otherwise provided in 13 CFR part 121, concerns are affiliates of each other when, either directly or indirectly:

(i) One concern controls or has the power to control the other; or

(ii) A third party or parties controls or has the power to control both; or

(iii) An identify of interest between or among parties exists such that affiliation may be found.

(2) In determining whether affiliation exists, it is necessary to consider all appropriate factors, including common ownership, common management, and contractual relationships. Affiliates must be considered together

in determining whether a concern meets small business size criteria and the statutory cap on the participation of forms in the DBE program.

Alaska Native means a citizen of the United States who is a person of one-fourth degree or more Alaskan Indian (including Tsimshian Indians not enrolled in the Metlaktla Indian Community), Eskimo, or Aleut Blood, or a Combination of those bloodlines. The term includes, in the absence of proof of a minimum blood quantum, any citizen whom a Native village or Native group regards as an Alaska Native if their father or mother is regarded as an Alaska Native.

Alaska Native Corporation (ANC) means any Regional Corporation, Village Corporation, Urban Corporation, or Group Corporation organized under the laws of the State of Alaska in accordance with the Alaska Native Claims Settlement Act, as amended (43 U.S.C. 1601, *et seq.*).

Compliance means that a recipient has correctly implemented the requirements of this part.

Contract means a legally binding relationship obligating a seller to furnish supplies or services (including, but not limited to, construction and professional services) and the buyer to pay for them. For purposes of this part, a lease is considered to be a contract.

Contractor means one who participates, through a contract or sub-contract (at any tier), in a DOT-assisted highway, transit, or airport program.

Department or *DOT* means the U.S. Department of Transportation, including the Office of the Secretary, the Federal Highway Administration (FHWA), the Federal

Transmit Administration (FTA), and the Federal Aviation Administration (FAA).

Disadvantaged business enterprise or *DBE* means a for-profit small business concern –

(1) That is at least 51 percent owned by one or more individuals who are both socially and economically disadvantaged or, in the case of a corporation, in which 51 percent of the stock is owned by one or more such individuals; and

(2) Whose management and daily business operations are controlled by one or more of the socially and economically disadvantaged individuals who own it.

DOT-assisted contract means any contract between a recipient and a contractor (at any tier) funded in whole or in part with DOT financial assistance, including letters of credit or loan guarantees, except a contract solely for the purchase of land.

Good faith efforts means efforts to achieve a DBE goal or other requirement of this part which, by their scope, intensity, and appropriateness to the objective, can reasonably be expected to fulfill the program requirement.

Immediate family member means father, mother, husband, wife, son, daugther, brother, sister, grandmother, grandfather, grandson, granddaugther, mother-in-law, or father-in-law.

Indian tribe means any Indian tribe, band, nation, or other organized group or community of Indians, including any ANC, which is recognized as eligible for the special programs and services provided by the United States to Indians because of their status as Indians, or is

recognized as such by the State in which the tribe, band, nation, group, or community resides. See definition of "tribally-owned concern" in this section.

Joint venture means an association of a DBE firm and one or more other firms to carry out a single, for-profit business enterprise, for which the parties combine their property, capital, efforts, skills and knowledge, and in which the DBE is responsible for a distinct, clearly defined portion of the work of the contract and whose share in the capital contribution, control, management, risks, and profits of the joint venture are commensurate with its ownership interest.

Native Hawaiian means any individual whose ancestors were natives, prior to 1778, of the area which now comprises the State of Hawaii.

Native Hawaiian Organization means any community service organization serving Native Hawaiians in the State of Hawaii which is a not-for-profit organization chartered by the State of Hawaii, is controlled by Native Hawaiians, and whose business activities will principally benefit such Native Hawaiians.

Noncompliance means that a recipient has not correctly implemented the requirements of this part.

Operating Administration or *OA* means any of the following parts of DOT: the Federal Aviation Administration (FAA), Federal Highway Administration (FHWA), and Federal Transit Administration (FTA). The "Administartor" of an operating administration includes his or her designees.

Personal net worth means the net value of the assets of an individual remaining after total liabilities are deducted. An individual's personal net worth does not include: The individual's ownership interest in an applicant or participating DBE firm; or the individual's equity in his or her primary place of residence. An individual's personal net worth includes only his or her own share of assets held jointly or as community property with the individual's spouse.

Primary industry classification means the four digit Standard Industrial Classification (SIC) code designation which best describes the primary business of a firm. The SIC code designations are described in the Standard Industry Classification Manual. As the North American Industrial Classification System (NAICS) replaces the SIC system, references to SIC codes and the SIC Manual are deemed to refer to the NAICS manual and applicable codes. The SIC Manual and the NAICS Manual are available through the National Technical Information Service (NTIS) of the U.S. Department of Commerce (Springfield, VA, 22261). NTIS also makes materials available through its web site (www.ntis.gov/naics).

Primary Recipient means a recipient which receives DOT financial assistance and passes some or all of it on to another recipient.

Principal place of business means the business location where the individuals who manage the firm's day-to-day operations spend most working hours and where top management's business records are kept. If the offices from which management is directed and where business records are kept are in different locations, the recipient

will determine the principal place of business for DBE program purposes.

Program means any undertaking on a recipient's part to use DOT financial assistance, authorized by the laws to which this part applies.

Race-conscious measure or program is one that is focused specifically on assisting only DBEs, including women-owned DBEs.

Race-neutral measure or program is one that is, or can be, used to assist all small businesses. For the purposes of this part, *race-neutral* includes gender-neutrality.

Recipient is any entity, public or private, to which DOT financial assistance is extended, whether directly or through another recipient, through the programs of the FAA, FHWA, or FTA, or who has applied for such assistance.

Secretary means the Secretary of Transportation or his/her designee.

Set-aside means a contracting practice restricting eligibility for the competitive award of a contract solely to DBE firms.

Small Business Administration or *SBA* means the United States Small Business Administration.

Small business concern means, with respect to firms seeking to participate as DBEs in DOT-assisted contracts, a small business concern as defined pursuant to section 3 of the Small Business Act and Small Business Administration regulations implementing it (13 CFR part 121) that

also does not exceed the cap on average annual gross receipts specified in § 26.65(b).

Socially and economically disadvantaged individual means any individual who is a citizen (or lawfully admitted permanent resident) of the United States and who is –

(1) Any individual who a recipient finds to be a socially and economically disadvantaged individual on a case-by-case basis.

(2) Any individual in the following groups, members of which are rebuttably presumed to be socially and economically disadvantaged:

(i) "Black Americans," which includes persons having origins in any of the Black racial groups of Africa;

(ii) "Hispanic Americans," which includes persons of Mexican, Puerto Rican, Cuban, Dominican, Central or South American, or other Spanish or Portuguese culture or origin, regardless of race;

(iii) "Native Americans," which includes persons who are American Indians, Eskimos, Aleuts, or Native Hawaiians;

(iv) "Asian-Pacific Americans," which includes persons whose origin are from Japan, China, Taiwan, Korea, Burma (Myanmar), Vietnam, Laos, Cambodia (Kampuchea), Thailand, Malasa, Indonesia, the Philippines, Brunei, Samoa, Guam, the U.S. Trust Territories of the Pacific Islands (Republic of Palau), the Commonwealth of the Northern Marianas Islands, Macao, Fiji, Tonga, Kirbati, Juvalu, Nauru, Federated States or Micronesia, or Hong Kong;

(v) "Subcontinent Asian Americans," which includes persons whose origins are from India, Pakistan, Bangledesh, Bhutan, the Maldives Islands, Nepal or Sri Lanka;

(vi) Women;

(vii) Any additional groups whose members are designated as socially and economically disadvantaged by the SBA, at such time as the SBA designation becomes effective.

Tribally-owned concern means any concern at least 51 percent owned by an Indian tribe as defined in this section.

You refers to a recipient, unless a statement in the text of this part or the context requires otherwise (i.e., 'You must do XYZ' means that recipients must do XYZ).

[64 FR 5126. Feb. 2, 1999, as amended at 64 FR 34570, June 28, 1999]

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49 C.F.R. § 26.7 (2000) What discriminatory actions are forbidden?

(a) You must never exclude any person from participation in, deny any person the benefits of, or otherwise discriminate against anyone in connection with the award and performance of any contract covered by this part on the basis of race, color, sex, or national origin.

(b) In administering your DBE program, you must not, directly or through contractual or other arrangements, use criteria or methods of administration that have the effect of defeating or substantially impairing accomplishment of the objectives of the program with respect to individuals of a particular race, color, sex, or national origin.

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49 C.F.R. § 26.51 (2000) What means do recipients use to meet overall goals?

(a) You must meet the maximum feasible portion of your overall goal by using race-neutral means of facilitating DBE participation. Race-neutral DBE participation includes any time a DBE wins a prime contract through customary competitive procurement procedures, is awarded a subcontract on a prime contract that does not carry a DBE goal, or even if there is a DBE goal, wins a subcontract from a prime contractor that did not consider its DBE status in making the award (e.g., a prime contractor that uses a strict low bid system to award subcontracts).

(b) Race-neutral means include, but are not limited to, the following:

(1) Arranging solicitations, times for the presentation of bids, quantities, specifications, and delivery schedules in ways that facilitate DBE, and other small businesses, participation (e.g., unbundling large contracts

to make them more accessible to small businesses, requiring or encouraging prime contractors to subcontract portions of work that they might otherwise perform with their own forces);

(2) Providing assistance in overcoming limitations such as inability to obtain bonding or financing (e.g., by such means as simplifying the bonding process, reducing bonding requirements, eliminating the impact of surety costs from bids, and providing services to help DBEs, and other small businesses, obtain bonding and financing);

(3) Providing technical assistance and other services;

(4) Carrying out information and communications programs on contracting procedures and specific contract opportunities (e.g., ensuring the inclusion of DBEs, and other small businesses, on recipient mailing lists for bidders; ensuring the dissemination to bidders on prime contracts of lists of potential subcontractors; provision of information in languages other than English, where appropriate);

(5) Implementing a supportive services program to develop and improve immediate and long-term business management, record keeping, and financial and accounting capability for DBEs and other small businesses;

(6) Providing services to help DBEs, and other small businesses, improve long-term development, increase opportunities to participate in a variety of kinds of work, handle increasingly significant projects, and achieve eventual self-sufficiency;

(7) Establishing a program to assist new, start-up firms, particularly in fields in which DBE participation has historically been low;

(8) Ensuring distribution of your DBE directory, through print and electronic means, to the widest feasible universe of potential prime contractors; and

(9) Assisting DBEs, and other small businesses, to develop their capability to utilize emerging technology and conduct business through electronic media.

(c) Each time you submit your overall goal for review by the concerned operating administration, you must also submit your projection of the portion of the goal that you expect to meet through race-neutral means and your basis for that projection. This projection is subject to approval by the concerned operating administration, in conjunction with its review of your overall goal.

(d) You must establish contract goals to meet any portion of your overall goal you do not project being able to meet using race-neutral means.

(e) The following provisions apply to the use of contract goals:

(1) You may use contract goals only on those DOT-assisted contracts that have subcontracting possibilities.

(2) You are not required to set a contract goal on every DOT-assisted contract. You are not required to set each contract goal at the same percentage level as the overall goal. The goal for a specific contract may be higher or lower than that percentage level of the overall goal, depending on such factors as the type of work involved, the location of the work, and the availability of

DBEs for the work of the particular contract. However, over the period covered by your overall goal, you must set contract goals so that they will cumulatively result in meeting any portion of your overall goal you do not project being able to meet through the use of race-neutral means.

(3) Operating administration approval of each contract goal is not necessarily required. However, operating administrations may review and approve or disapprove any contract goal you establish.

(4) Your contract goals must provide for participation by all certified DBEs and must not be subdivided into group-specific goals.

(f) To ensure that your DBE program continues to be narrowly tailored to overcome the effects of discrimination, you must adjust your use of contract goals as follows:

(1) If your approved projection under paragraph (c) of this section estimates that you can meet your entire overall goal for a given year through race-neutral means, you must implement your program without setting contract goals during that year.

Example to Paragraph (f)(1): Your overall goal for Year I is 12 percent. You estimate that you can obtain 12 percent or more DBE participation through the use of race-neutral measures, without any use of contract goals. In this case, you do not set any contract goals for the contracts that will be performed in Year I.

(2) If, during the course of any year in which you are using contract goals, you determine that you will

exceed your overall goal, you must reduce or eliminate the use of contract goals to the extent necessary to ensure that the use of contract goals does not result in exceeding the overall goal. If you determine that you will fall short of your overall goal, then you must make appropriate modifications in your use of race-neutral and/or race-conscious measures to allow you to meet the overall goal.

Example to Paragraph (f)(2): In Year II, your overall goal is 12 percent. You have estimated that you can obtain 5 percent DBE participation through use of race-neutral measures. You therefore plan to obtain the remaining 7 percent participation through use of DBE goals. By September, you have already obtained 11 percent DBE participation for the year. For contracts let during the remainder of the year, you use contract goals only to the extent necessary to obtain an additional one percent DBE participation. However, if you determine in September that your participation for the year is likely to be only 8 percent total, then you would increase your use of race-neutral and/or race-conscious means during the remainder of the year in order to achieve your overall goal.

(3) If the DBE participation you have obtained by race-neutral means alone meets or exceeds your overall goals for two consecutive years, you are not required to make a projection of the amount of your goal you can meet using such means in the next year. You do not set contract goals on any contracts in the next year. You continue using only race-neutral means to meet your overall goals unless and until you do not meet your overall goal for a year.

Example to Paragraph (f)(3): Your overall goal for Years I and Year II is 10 percent. The DBE participation you obtain through race-neutral measures alone is 10 percent or more in each year. (For this purpose, it does not matter whether you obtained additional DBE participation through using contract goals in these years.) In Year III and following years, you do not need to make a projection under paragraph (c) of this section of the portion of your overall goal you expect to meet using race-neutral means. You simply use race-neutral means to achieve your overall goals. However, if in Year VI your DBE participation falls short of your overall goal, then you must make a paragraph (c) projection for Year VII and, if necessary, resume use of contract goals in that year.

(4) If you obtain DBE participation that exceeds your overall goal in two consecutive years through the use of contract goals (i.e., not through the use of race-neutral means alone), you must reduce your use of contract goals proportionately in the following year.

Example to Paragraph (f)(4): In Years I and II, your overall goal is 12 percent, and you obtain 14 and 16 percent DBE participation, respectively. You have exceeded your goals over the two-year period by an average of 25 percent. In Year III, your overall goal is again 12 percent, and your paragraph (c) projection estimates that you will obtain 4 percent DBE participation through race-neutral means and 8 percent through contract goals. You then reduce the contract goal projection by 25 percent (i.e., from 8 to [illegible] percent) and set contract goals accordingly during the year. If in Year III

you obtain 11 percent participation, you do not use this contract goal adjustment mechanism for Year IV, because there have not been two *consecutive* years of exceeding overall goals.

(g) In any year in which you project meeting part of your goal through race-neutral means and the remainder through contract goals, you must maintain data separately on DBE achievements in those contracts with and without contract goals, respectively. You must report this data to the concerned operating administration as provided in § 26.11.

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49 C.F.R. § 26.61 (2000) How are burdens of proof allocated in the certification process?

(a) In determining whether to certify a firm as eligible to participate as a DBE, you must apply the standards of this subpart.

(b) The firm seeking certification has the burden of demonstrating to you, that it meets the requirements of this subpart concerning group membership or individual disadvantage, business size, ownership, and control.

(c) You must rebuttably presume that members of the designated groups identified in § 26.67(a) are socially and economically disadvantaged. This means that they do not have the burden of proving to you that they are socially and economically disadvantaged. However, applicants have the obligation to provide you information concerning their economic disadvantage (see § 26.67).

(d) Individuals who are not presumed to be socially and economically disadvantaged, and individuals concerning whom the presumption of disadvantage has been rebutted, have the burden of proving to you, by a preponderance of the evidence, that they are socially and economically disadvantaged. (See Appendix E of this part.)

(e) You must make determinations concerning whether individuals and firms have met their burden of demonstrating group membership, ownership, control, and social and economic disadvantage (where disadvantage must be demonstrated on an individual basis) by considering all the facts in the record, viewed as a whole.

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49 C.F.R. § 26.63 (2000) What rules govern group membership determinations?

(a) If you have reason to question whether an individual is a member of a group that is presumed to be socially and economically disadvantaged, you must require the individual to demonstrate, by a preponderance of the evidence, that he or she is a member of the group.

(b) In making such a determination, you must consider whether the person has held himself out to be a member of the group over a long period of time prior to application for certification and whether the person is regarded as a member of the group by the relevant community. You may require the applicant to produce appropriate documentation of group membership.

(1) If you determine that an individual claiming to be a member of a group presumed to be disadvantaged is not a member of a designated disadvantaged group, the individual must demonstrate social and economic disadvantage on an individual basis.

(2) Your decisions concerning membership in a designated group are subject to the certification appeals procedure of § 26.89.

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49 C.F.R. § 26.67 (2000) What rules determine social and economic disadvantage?

(a) *Presumption of disadvantage.* (1) You must rebuttably presume that citizens of the United States (or lawfully admitted permanent residents) who are women, Black Americans, Hispanic Americans, Native Americans, Asian-Pacific Americans, Subcontinent Asian Americans, or other minorities found to be disadvantaged by the SBA, are socially and economically disadvantaged individuals. You must require applicants to submit a signed, notarized certification that each presumptively disadvantaged owner is, in fact, socially and economically disadvantaged.

(2)(i) You must require each individual owner of a firm applying to participate as a DBE (except a firm applying to participate as a DBE airport concessionaire) whose ownership and control are relied upon for DBE certification to submit a signed, notarized statement of

personal net worth, with appropriate supporting documentation. This statement and documentation must not be unduly lengthy, burdensome, or intrusive.

(ii) Notwithstanding any provision of state law, you must not release an individual's personal net worth statement nor any documentation supporting it to any third party without the written consent of the submitter. *Provided,* that you must transmit this information to DOT in any certification appeal proceeding under § 26.89 in which the disadvantaged status of the individual is in question.

(iii) In determining net worth, you must exclude an individual's ownership interest in the applicant firm and the individual's equity in his or her primary residence (except any portion of such equity that is attributable to excessive withdrawals from the applicant firm). A contingent liability does not reduce an individual's net worth. The personal net worth of an individual claiming to be an Alaska Native will include assets and income from sources other than an Alaska Native corporation and exclude any of the following which the individual receives from any Alaska Native Corporation: cash (including cash dividends on stock received from an ANC) to the extent that it does not, in the aggregate, exceed $2,000 per individual per annum; stock (including stock issued or distributed by an ANC as a dividend or distribution on stock); a partnership interest; land or an interest in land (including land or an interest in land received from an ANC as a dividend or distribution on stock); and an interest in a settlement trust.

(b) *Rebuttal of presumption of disadvantage.* (1) If the statement of personal net worth that an individual submits under paragraph (a)(2) of this section shows that the individual's personal net worth exceeds $750,000, the individual's presumption of economic disadvantage is rebutted. You are not required to have a proceeding under paragraph (b)(2) of this section in order to rebut the presumption of economic disadvantage in this case.

(2) If you have a reasonable basis to believe that an individual who is a member of one of the designated groups is not, in fact, socially and/or economically disadvantaged you may, at any time, start a proceeding to determine whether the presumption should be regarded as rebutted with respect to that individual. Your proceeding must follow the procedures of § 26.87.

(3) In such a proceeding, you have the burden of demonstrating, by a preponderance of the evidence, that the individual is not socially and economically disadvantaged. You may require the individual to produce information relevant to the determination of his or her disadvantage.

(4) When an individual's presumption of social and/or economic disadvantage has been rebutted, his or her ownership and control of the firm in question cannot be used for purposes of DBE eligibility under this subpart unless and until he or she makes an individual showing of social and/or economic disadvantage. If the basis for rebutting the presumption is a determination that the individual's personal net worth exceeds $750,000, the individual is no longer eligible for participation in the

program and cannot regain eligibility by making an individual showing of disadvantage.

(c) *8(a) and SDB Firms.* If a firm applying for certification has a current, valid certification from or recognized by the SBA under the 8(a) or small and disadvantaged business (SDB) program (except an SDB certification based on the firm's self-certification as an SDB), you may accept the firm's 8(a) or SDB certification in lieu of conducting your own certification proceeding, just as you may accept the certification of another DOT recipient for this purpose. You are not required to do so, however.

(d) *Individual determinations of social and economic disadvantage.* Firms owned and controlled by individuals who are not presumed to be socially and economically disadvantaged (including individuals whose presumed disadvantage has been rebutted) may apply for DBE certification. You must make a case-by-case determination of whether each individual whose ownership and control are relied upon for DBE certification is socially and economically disadvantaged. In such a proceeding, the applicant firm has the burden of demonstrating to you, by a preponderance of the evidence, that the individuals who own and control it are socially and economically disadvantaged. An individual whose personal net worth exceeds $750,000 shall not be deemed to be economically disadvantaged. In making these determinations, use the guidance found in Appendix E of this part. You must require that applicants provide sufficient information to permit determinations under the guidance of Appendix E of this part.

[64 FR 5126, Feb. 2, 1999, as amended at 64 FR 34570, June 28, 1999]

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49 C.F.R. § 26.83 (2000) What procedures do recipients follow in making certification decisions?

(a) You must ensure that only firms certified as eligible DBEs under this section participate as DBEs in your program.

(b) You must determine the eligibility of firms as DBEs consistent with the standards of subpart D of this part. When a UCP is formed, the UCP must meet all the requirements of subpart D of this part and this subpart that recipients are required to meet.

(c) You must take all the following steps in determining whether a DBE firm meets the standards of subpart D of this part:

(1) Perform an on-site visit to the offices of the firm. You must interview the principal officers of the firm and review their resumes and/or work histories. You must also perform an on-site visit to job sites if there are such sites on which the firm is working at the time of the eligibility investigation in your jurisdiction or local area. You may rely upon the site visit report of any other recipient with respect to a firm applying for certification;

(2) If the firm is a corporation, analyze the ownership of stock in the firm;

(3) Analyze the bonding and financial capacity of the firm;

(4) Determine the work history of the firm, including contracts it has received and work it has completed;

(5) Obtain a statement from the firm of the type of work it prefers to perform as part of the DBE program and its preferred locations for performing the work, if any;

(6) Obtain or compile a list of the equipment owned by or available to the firm and the licenses the firm and its key personnel possess to perform the work it seeks to do as part of the DBE program;

(7) Require potential DBEs to complete and submit an appropriate application form.

(i) *Uniform form.* [Reserved]

(ii) You must make sure that the applicant attests to the accuracy and truthfulness of the information on the application form. This shall be done either in the form of an affidavit sworn to by the applicant before a person who is authorized by state law to administer oaths or in the form of an unsworn declaration executed under penalty of perjury of the laws of the United States.

(iii) You must review all information on the form prior to making a decision about the eligibility of the firm.

(d) When another recipient, in connection with its consideration of the eligibility of a firm, makes a written request for certification information you have obtained about that firm (e.g., including application materials or the report of a site visit, if you have made one to the firm), you must promptly make the information available to the other recipient.

(e) When another DOT recipient has certified a firm, you have discretion to take any of the following actions;

(1) Certify the firm in reliance on the certification decision of the other recipient;

(2) Make an independent certification decision based on documentation provided by the other recipient, augmented by any additional information you require the applicant to provide; or

(3) Require the applicant to go through your application process without regard to the action of the other recipient.

(f) Subject to the approval of the concerned operating administration as part of your DBE program, you may impose a reasonable application fee for certification. Fee waivers shall be made in appropriate cases.

(g) You must safeguard from disclosure to unauthorized persons information gathered as part of the certification process that may reasonably be regarded as proprietary or other confidential business information, consistent with applicable Federal, state, and local law.

(h) Once you have certified a DBE, it shall remain certified for a period of at least three years unless and until its certification has been removed through the procedures of § 26.87. You may not require DBEs to reapply for certification as a condition of continuing to participate in the program during this three-year period, unless the factual basis on which the certification was made changes.

(i) If you are a DBE, you must inform the recipient or UCP in writing of any change in circumstances affecting your ability to meet size, disadvantaged status, ownership, or control requirements of this part or any material change in the information provided in your application form.

(1) Changes in management responsibility among members of a limited liability company are covered by this requirement.

(2) You must attach supporting documentation describing in detail the nature of such changes.

(3) The notice must take the form of an affidavit sworn to by the applicant before a person who is authorized by state law to administer oaths or of an unsworn declaration executed under penalty of perjury of the laws of the United States. You must provide the written notification within 30 days of the occurrence of the change. If you fail to make timely notification of such a change, you will be deemed to have failed to cooperate under § 26.109(c).

(j) If you are a DBE, you must provide to the recipient, every year on the anniversary of the date of your certification, an affidavit sworn to by the firm's owners before a person who is authorized by state law to administer oaths or an unsworn declaration executed under penalty of perjury of the laws of the United States. This affidavit must affirm that there have been no changes in the firm's circumstances affecting its ability to meet size, disadvantaged status, ownership, or control requirements of this part or any material changes in the information provided in its application form, except for changes about

which you have notified the recipient under paragraph (i) of this section. The affidavit shall specifically affirm that your firm continues to meet SBA business size criteria and the overall gross receipts cap of this part, documenting this affirmation with supporting documentation of your firm's size and gross receipts. If you fail to provide this affidavit in a timely manner, you will be deemed to have failed to cooperate under § 26.109(c).

(k) If you are a recipient, you must make decisions on applications for certification within 90 days of receiving from the applicant firm all information required under this part. You may extend this time period once, for no more than an additional 60 days, upon written notice to the firm, explaining fully and specifically the reasons for the extension. You may establish a different time frame in your DBE program, upon a showing that this time frame is not feasible, and subject to the approval of the concerned operating administration. Your failure to make a decision by the applicable deadline under this paragraph is deemed a constructive denial of the application, on the basis of which the firm may appeal to DOT under § 26.89.

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49 C.F.R. § 26.87 (2000) What procedures does a recipient use to remove a DBE's eligibility?

(a) *Ineligibility complaints.* (1) Any person may file with you a written complaint alleging that a currently-certified firm is ineligible and specifying the alleged reasons why the firm is ineligible. You are not required to

accept a general allegation that a firm is ineligible or an anonymous complaint. The complaint may include any information or arguments supporting the complainant's assertion that the firm is ineligible and should not continue to be certified. Confidentiality of complainants' identities must be protected as provided in § 26.109(b).

(2) You must review your records concerning the firm, any material provided by the firm and the complainant, and other available information. You may request additional information from the firm or conduct any other investigation that you deem necessary.

(3) If you determine, based on this review, that there is reasonable cause to believe that the firm is ineligible, you must provide written notice to the firm that you propose to find the firm ineligible, setting forth the reasons for the proposed determination. If you determine that such reasonable cause does not exist, you must notify the complainant and the firm in writing of this determination and the reasons for it. All statements of reasons for findings on the issue of reasonable cause must specifically reference the evidence in the record on which each reason is based.

(b) *Recipient-initiated proceedings.* If, based on notification by the firm of a change in its circumstances or other information that comes to your attention, you determine that there is reasonable cause to believe that a currently certified firm is ineligible, you must provide written notice to the firm that you propose to find the firm ineligible, setting forth the reasons for the proposed determination. The statement of reasons for the finding of

reasonable cause must specifically reference the evidence in the record on which each reason is based.

(c) *DOT directive to initiate proceeding.* (1) If the concerned operating administration determines that information in your certification records, or other information available to the concerned operating administration, provides reasonable cause to believe that a firm you certified does not meet the eligibility criteria of this part, the concerned operating administration may direct you to initiate a proceeding to remove the firm's certification.

(2) The concerned operating administration must provide you and the firm a notice setting forth the reasons for the directive. Including any relevant documentation or other information.

(3) You must immediately commence and prosecute a proceeding to remove eligibility as provided by paragraph (b) of this section.

(d) *Hearing.* When you notify a firm that there is reasonable cause to remove its eligibility, as provided in paragraph (a), (b), or (c) of this section, you must give the firm an opportunity for an informal hearing, at which the firm may respond to the reasons for the proposal to remove its eligibility in person and provide information and arguments concerning why it should remain certified.

(1) In such a proceeding, you bear the burden of proving, by a preponderance of the evidence, that the firm does not meet the certification standards of this part.

(2) You must maintain a complete record of the hearing, by any means acceptable under state law for the

retention of a verbatim record of an administrative hearing. If there is an appeal to DOT under § 26.89, you must provide a transcript of the hearing to DOT and, on request, to the firm. You must retain the original record of the hearing. You may charge the firm only for the cost of copying the record.

(3) The firm may elect to present information and arguments in writing, without going to a hearing. In such a situation, you bear the same burden of proving, by a preponderance of the evidence, that the firm does not meet the certification standards, as you would during a hearing.

(e) *Separation of functions.* You must ensure that the decision in a proceeding to remove a firm's eligibility is made by an office and personnel that did not take part in actions leading to or seeking to implement the proposal to remove the firm's eligibility and are not subject, with respect to the matter, to direction from the office or personnel who did take part in these actions.

(1) Your method of implementing this requirement must be made part of your DBE program.

(2) The decisionmaker must be an individual who is knowledgeable about the certification requirements of your DBE program and this part.

(3) Before a UCP is operational in its state, a small airport or small transit authority (i.e., an airport or transit authority serving an area with less than 250,000 population) is required to meet this requirement only to the extent feasible.

(f) *Grounds for decision.* You must not base a decision to remove eligibility on a reinterpretation or changed opinion of information available to the recipient at the time of its certification of the firm. You may base such a decision only on one or more of the following:

(1) Changes in the firm's circumstances since the certification of the firm by the recipient that render the firm unable to meet the eligibility standards of this part;

(2) Information or evidence not available to you at the time the firm was certified;

(3) Information that was concealed or misrepresented by the firm in previous certification actions by a recipient;

(4) A change in the certification standards or requirements of the Department since you certified the firm; or

(5) A documented finding that your determination to certify the firm was factually erroneous.

(g) *Notice of decision.* Following your decision, you must provide the firm written notice of the decision and the reasons for it, including specific references to the evidence in the record that supports each reason for the decision. The notice must inform the firm of the consequences of your decision and of the availability of an appeal to the Department of Transportation under § 26.89. You must send copies of the notice to the complainant in an ineligibility complaint or the concerned operating administration that had directed you to initiate the proceeding.

(h) *Status of firm during proceeding.* (1) A firm remains an eligible DBE during the pendancy of your proceeding to remove its eligibility.

(2) The firm does not become ineligible until the issuance of the notice provided for in paragraph (g) of this section.

(i) *Effects of removal of eligibility.* When you remove a firm's eligibility, you must take the following action:

(1) When a prime contractor has made a commitment to using the ineligible firm, or you have made a commitment to using a DBE prime contractor, but a subcontract or contract has not been executed before you issue the decertification notice provided for in paragraph (g) of this section, the ineligible firm does not count toward the contract goal or overall goal. You must direct the prime contractor to meet the contract goal with an eligible DBE firm or demonstrate to you that it has made a good faith effort to do so.

(2) If a prime contractor has executed a subcontract with the firm before you have notified the firm of its ineligibility, the prime contractor may continue to use the firm on the contract and may continue to receive credit toward its DBE goal for the firm's work. In this case, or in a case where you have let a prime contract to the DBE that was later ruled ineligible, the portion of the ineligible firm's performance of the contract remaining after you issued the notice of its ineligibility shall not count toward your overall goal, but may count toward the contract goal.

(3) *Exception*: If the DBE's ineligibility is caused solely by its having exceeded the size standard during the performance of the contract, you may continue to count its participation on that contract toward overall and contract goals.

(j) *Availability of appeal.* When you make an administratively final removal of a firm's eligibility under this section, the firm may appeal the removal to the Department under § 26.89.

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49 C.F.R. (2000)

APPENDIX E TO PART 26 – INDIVIDUAL DETERMINATIONS OF SOCIAL AND ECONOMIC DISADVANTAGE

The following guidance is adapted with minor modifications, from SBA regulations concerning social and economic disadvantage determinations (see 13 CFR 124.103(c) and 124.104).

SOCIAL DISADVANTAGE

I. Socially disadvantaged individuals are those who have been subjected to racial or ethnic prejudice or cultural bias within American society because of their identities as members of groups and without regard to their individual qualities. Social disadvantage must stem from circumstances beyond their control. Evidence of individual social disadvantage must include the following elements:

(A) At least one objective distinguishing feature that has contributed to social disadvantage, such as race, ethnic origin, gender, disability, long-term residence in an environment isolated from the mainstream of American society, or other similar causes not common to individuals who are not socially disadvantaged;

(B) Personal experience of substantial and chronic social disadvantage in American society, not in other countries; and

(C) Negative impact on entry into or advancement in the business world because of the disadvantage. Recipients will consider any relevant evidence in assessing this element. In every case, however, recipients will consider education, employment and business history, where applicable, to see if the totality of circumstances shows disadvantage in entering into or advancing in the business world.

(1) *Education.* Recipients will consider such factors as denial of equal access to institutions of higher education and vocational training, exclusion from social and professional association with students or teachers, denial of educational honors rightfully earned, and social patterns or pressures which discouraged the individual from pursuing a professional or business education.

(2) *Employment.* Recipients will consider such factors as unequal treatment in hiring, promotions and other aspects of professional advancement, pay and fringe benefits, and other terms and conditions of employment; retaliatory or discriminatory behavior by an employer or labor union; and social patterns or pressures which have

channeled the individual into non-professional or non-business fields.

(3) *Business history.* The recipient will consider such factors as unequal access to credit or capital, acquisition of credit or capital under commercially unfavorable circumstances, unequal treatment in opportunities for government contracts or other work, unequal treatment by potential customers and business associates, and exclusion from business or professional organizations.

II. With respect to paragraph 1.(A) of this appendix, the Department notes that people with disabilities have disproportionately low incomes and high rates of unemployment. Many physical and attitudinal barriers remain to their full participation in education, employment, and business opportunities available to the general public. The Americans with Disabilities Act (ADA) was passed in recognition of the discrimination faced by people with disabilities. It is plausible that many individuals with disabilities – especially persons with severe disabilities (e.g., significant mobility, vision, or hearing impairments) – may be socially and economically disadvantaged.

III. Under the laws concerning social and economic disadvantage, people with disabilities are not a group presumed to be disadvantaged. Nevertheless, recipients should look carefully at individual showings of disadvantage by individuals with disabilities, making a case-by-case judgment about whether such an individual meets the criteria of this appendix. As public entities subject to Title II of the ADA, recipients must also ensure their DBE programs are accessible to individuals with disabilities. For example, physical barriers or the lack of application

and information materials in accessible formats cannot be permitted to thwart the access of potential applicants to the certification process or other services made available to DBEs and applicants.

ECONOMIC DISADVANTAGE

(A) *General.* Economically disadvantaged individuals are socially disadvantaged individuals whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities as compared to others in the same or similar line of business who are not socially disadvantaged.

(B) *Submission of narrative and financial information.*

(1) Each individual claiming economic disadvantage must describe the conditions which are the basis for the claim in a narrative statement, and must submit personal financial information.

(2) When married, an individual claiming economic disadvantage also must submit separate financial information for his or her spouse, unless the individual and the spouse are legally separated.

(C) *Factors to be considered.* In considering diminished capital and credit opportunities, recipients will examine factors relating to the personal financial condition of any individual claiming disadvantaged status, including personal income for the past two years (including bonuses and the value of company stock given in lieu of cash), personal net worth, and the fair market value of all assets, whether encumbered or not. Recipients will

also consider the financial condition of the applicant compared to the financial profiles of small businesses in the same primary industry classification, or, if not available, in similar lines of business, which are not owned and controlled by socially and economically disadvantaged individuals in evaluating the individual's access to credit and capital. The financial profiles that recipients will compare include total assets, net sales, pre-tax profit, sales/working capital ratio, and net worth.

(D) *Transfers within two years.*

(1) Except as set forth in paragraph (D)(2) of this appendix, recipients will attribute to an individual claiming disadvantaged status any assets which that individual has transferred to an immediate family member, or to a trust, a beneficiary of which is an immediate family member, for less than fair market value, within two years prior to a concern's application for participation in the DBE program, unless the individual claiming disadvantaged status can demonstrate that the transfer is to or on behalf of an immediate family member for that individual's education, medical expenses, or some other form of essential support.

(2) Recipients will not attribute to an individual claiming disadvantaged status any assets transferred by that individual to an immediate family member that are consistent with the customary recognition of special occasions, such as birthdays, graduations, anniversaries, and retirements.

(3) In determining an individual's access to capital and credit, recipients may consider any assets that the individual transferred within such two-year period

described by paragraph (D)(1) of this appendix that are not considered in evaluating the individual's assets and net worth (e.g., transfers to charities).